Supreme Court, U.S.
FILED

06 1212 MAR 05 2007

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No. 06-

IN THE

Supreme Court of the United States

TWO TREES, a New York general partnership, DAVID C. WALENTAS and JANE WALENTAS,

Petitioners,

v.

BUILDERS TRANSPORT, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The petitioners herein, Two Trees and its general partners, David C. Walentas and Jane Walentas (collectively, "Two Trees"), respectfully seek Supreme Court review from a decision of the Eleventh Circuit Court of Appeals, which erroneously held that excess proceeds of a standby $1.6 million letter of credit (the "Letter of Credit"), established as security under a sale/leaseback transaction, constitute property of a bankruptcy estate within the meaning of 11 U.S.C. § 541.

As a matter of long-standing commercial practice, letters of credit are unaffected by any disputes in the underlying contract between the applicant and beneficiary based upon the Independence Principle. For purposes of bankruptcy, the most important consequence of the Independence Principle is that letters of credit are not considered part of a debtor's estate since the proceeds constitute the property of the issuing or paying bank. Nevertheless, the Eleventh Court incorrectly treated the Letter of Credit as the equivalent of a conventional cash security deposit, transforming the proceeds into property of the Respondent, Builders Transport Inc.'s ("BTI") bankruptcy estate, and thereby subjecting them to turnover under 11 U.S.C. § 542(b).

In holding that the proceeds are subject to turnover, the Eleventh Circuit ruling is in conflict with the holding of the Fifth Circuit Court of Appeals in *EOP-Colonnade of Dallas Ltd. Partnership v. Faulkner* (*In re Stonebridge Technologies, Inc.*), 430 F.3d 260 (5th Cir. 2005), which gives proper recognition to the Independence Principle to hold that a landlord's retention of letter of credit proceeds is not subject to a turnover ~~action in bankruptcy~~ where the landlord does

not assert a claim against the debtor/tenant and relies on the third-party letter of credit as its sole source of recovery.

Accordingly, the question presented for review is as follows:

Whether and under what circumstances the proceeds of a standby letter of credit established as a lease security deposit are subject to a turnover proceeding in bankruptcy by virtue of the provisions of 11 U.S.C. § 502(b)(6) or otherwise?

LIST OF PARTIES

The parties to this appeal are listed in the caption.

CORPORATE DISCLOSURE STATEMENT

Two Trees is a privately held New York general partnership which is not publicly traded. Its sole general partners are individuals.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit is reported at 471 F.3d 1178 (11th Cir. 2006). The Eleventh Circuit affirmed the various orders and decisions that were rendered by the district and bankruptcy courts, respectively, in connection with bifurcated proceedings on liability and damages, identified as follows: (i) the July 7, 2003 Order of the United States District Court for the Northern District of Georgia, which affirmed the September 30, 2002 Order of the United States Bankruptcy Court for the Northern District of Georgia granting partial summary judgment as to the issue of liability; and (ii) the September 30, 2005 Order of the United States District Court for the Northern District of Georgia, which affirmed the July 15, 2004 Judgment of the Bankruptcy Court. None of the lower court decisions and orders are officially reported.

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The Eleventh Circuit's decision was rendered on December 5, 2006.

FEDERAL STATUTORY PROVISIONS INVOLVED

Title 11 United States Code, Sections 541(a)(1), 542(b) and 502(b)(6), respectively, as quoted below.

11 U.S.C. § 541(a)(1) provides as follows:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 542(b) provides as follows:

(b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

11 U.S.C. § 502(b)(6) provides as follows:

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the

date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

. . .

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

STATEMENT OF THE CASE

A. *Introduction*

Rarely does a case present a clearer example of unanticipated, unintended, and fundamentally inequitable consequences, which ultimately caused petitioner Two Trees to incur millions of dollars in financial losses. Two Trees only became involved in a carefully orchestrated sale/leaseback transaction in strict reliance that it would not be exposed to any significant financial liability. In fact, all of the original parties to the sale/leaseback sought to limit any potential risk to Two Trees through the introduction of the Letter of Credit. This was done in keeping with a bedrock commercial expectation in this country that a letter of credit constitutes an inviolate form of third-party security, not subject to attack in bankruptcy.

All of these expectations were roundly nullified in the wake of the Eleventh Circuit decision. This ruling erroneously stripped Two Trees of the protections of the Letter of Credit during the course of BTI's subsequent bankruptcy in a decision which conflicts with the Fifth Circuit. If left undisturbed, the Eleventh Circuit's improvident holding not only perpetuates a grave injustice to Two Trees, but improperly allows for potential recovery against landlords generally in a manner not intended by Congress. The Eleventh Circuit decision also adversely affects the flow of commerce by placing a cloud over the expectations of hundreds of thousands of parties engaged in commercial and real estate transactions that have come to rely on the sanctity of letters of credit.

Accordingly, we beseech the Court to grant certiorari to clarify and protect the rights of landlords under the Bankruptcy Code, to resolve the conflict among the circuits relating to disposition of letters of credit in bankruptcy so as to promote uniformity in commercial transactions and, finally, to undo the harm and indignity suffered by Two Trees as a result of the lower courts' failure to properly apply the Independence Principle.

Under the correct analysis of the issue by the Fifth Circuit in *Stonebridge, supra*, any limitation on a landlord's recovery of damages under 11 U.S.C. § 502(b)(6) applies only if a proof of claim has been filed. Furthermore, there is nothing in the plain language of the Bankruptcy Code to limit a landlord's recovery against third-party sources. To the contrary, a straight-forward reading of 11 U.S.C. § 502(b)(6) makes clear that the statute does *not* allow a turnover of proceeds against a landlord which, like Two Trees, did not assert a claim in bankruptcy.

B. *Background Facts Relating To The Sale/Leaseback*

BTI was previously engaged in the business of interstate trucking and maintained headquarters in Camden, South Carolina (the "Headquarters"). Earlier in its existence, BTI invested in a failed satellite messaging company which generated a remaining capital loss carrying forward of $1,530,000 that was due to expire at the end of 1995. Also by 1995, BTI had fully satisfied various local revenue bonds encumbering its Headquarters, and saw the opportunity to restructure ownership of its Headquarters so as to position itself to take advantage of the then expiring capital loss carry forward through a sale/leaseback. To this end, BTI arranged for the Headquarters to be sold at a "controlled" purchase

price of $3.5 million, set by BTI to yield the desired capital gain of approximately $1.5 million to offset against the expiring loss.

To effectuate the sale/leaseback, an intermediary was needed to act as a purchaser of the Headquarters and simultaneous lessor to BTI. Two Trees ultimately came to fulfill this role as an accommodation to BTI after several institutions and private lenders either passed on the deal or sought excessive fees and commissions. The sale/leaseback was structured as follows: Two Trees agreed to purchase the Headquarters from BTI for the sum of $3.5 million via one hundred percent mortgage financing provided by CIT Group/ Business Credit, Inc. ("CIT"). At the time, CIT, which was already BTI's primary lender under multiple credit facilities, had a keen interest in improving the liquidity of its borrower, and was deeply involved in structuring the sale/leaseback on multiple levels.

Simultaneously with the purchase, Two Trees entered into an agreement to lease the Headquarters back to BTI at a monthly rental equal to the monthly debt service of principal and interest owed to CIT under Two Trees' mortgage (dollar-for-dollar). The lease was structured to be a complete pass-through arrangement, with rent paid directly to CIT as the holder of the mortgage and the designated Facility Mortgagee under the lease.

Importantly, because the sale/leaseback was specifically designed to achieve a targeted capital gain of $1.5 million, the $3.5 million purchase price did not necessarily correspond to the market value of the Headquarters. Thus, Two Tree's obligations to CIT under the mortgage were not adequately

collateralized by the Headquarters alone, and additional credit support was needed to bridge the gap between the controlled purchase price and the actual value of the Headquarters. Hence, the introduction of the Letter of Credit as a security deposit under the lease.

The Letter of Credit was obtained at CIT's request and could be drawn-down as one of the remedies for "any damages sustained by lessor arisingout of termination of the lease." The Letter of Credit was simultaneously assigned to CIT at the closing, further confirming that it also functionally collateralized the mortgage obligation, even though BTI was advised not to formally guarantee Two Tree's mortgage to CIT for fear of jeopardizing the tax treatment of the sale/leaseback. Nevertheless, the lease allowed recovery of all additional expenses incurred by Two Trees in the event of termination of the lease, which were defined to include both *direct* and *indirect* damages. The reference to indirect damages (which covered actions taken by CIT) was mainly intended to capture the parties overall recognition that the Letter of Credit ultimately stood as security for both lease and the mortgage obligations given the undeniable inter-relatedness of the various instruments.

The parties settled on the Letter of Credit as the additional credit enhancement based upon the shared understanding and belief that it would not be affected by bankruptcy since the proceeds represented the funds of a third-party financial institution. While Two Tree's principal, David Walentas, served as the Chairman of the Board of BTI in 1995, he was not a strategist of the sale/leaseback which was formulated by BTI's day-to-day operating officers in consultation with BTI's professional advisors. From Two Tree's perspective, it would not have participated in the sale/

leaseback absent the protections afforded by the Letter of Credit to negate potential exposure under the mortgage arising from the fact that the principal indebtedness exceeded the market value of the Headquarters. Two Trees' reasonable and legitimate expectations regarding its lack of financial risk were dramatically altered by the subsequent Chapter 11 filing made by BTI in 1998.

C. *The Turnover Proceedings*

Soon after commencement of Chapter 11 proceedings, BTI ceased active business operations and sold substantially all of its assets. In the meantime, CIT drew-down on the Letter of Credit to reduce the mortgage debt in contemplation of BTI's termination of its lease with Two Trees.

More than a year after the sale of its assets, BTI filed a complaint against Two Trees and CIT under 11 U.S.C. § 542(b) alleging, in substance, that the proceeds of the Letter of Credit constituted property of the bankruptcy estate, and were subject to turnover to the extent they exceed Two Trees' allowed damages, as lessor, under 11 U.S.C. § 502(b)(6). Considering that BTI had already enjoyed the benefits of the sale/leaseback years earlier through the benevolence of Two Trees, the subsequent turnover complaint can only be described as an act of treachery. Both Two Trees and CIT defended against the turnover complaint on multiple, but similar grounds, including reliance on the Independence Principle applicable to letters of credit. The gravamen of this defense was based on the contention that the proceeds of the Letter of Credit constituted the property of the paying bank, not BTI, and, therefore were not subject to a turnover or the limitation of a landlord's damages under 11 U.S.C.

§ 502(b)(6). Significantly, Two Trees never filed a proof of claim in connection with BTI's bankruptcy case and relied on the Letter of Credit as its sole source of recovery following rejection of the lease.

On September 30, 2002, the Bankruptcy Court, disregarding proper application of the Independence Principle, granted partial summary judgment directing a turnover of the proceeds of the Letter of Credit. The Bankruptcy Court ruling on liability was affirmed by the District Court on July 7, 2003.

D. ***The Damage Assessment***

After liability was determined, the parties litigated over the issue of the proper amount of Two Trees' allowed lease rejection damages under the framework of 11 U.S.C. § 502(b)(6). In bankruptcy, the rejection of a lease is considered a breach that occurs on the day before the bankruptcy filing (11 U.S.C. § 502(g)) and gives rise to a general unsecured claim for damages. Fearing that damages emanating from a long-term lease would dominate the pool of unsecured debt, the Bankruptcy Code provides a statutory cap on the amount of the recoverable damages by a landlord in the event of a lease termination. This cap is codified at 11 U.S.C. § 502(b)(6) and essentially provides that the landlord's claim may not exceed the greater of the rent reserved under the lease for one year, or fifteen percent, not to exceed three years, of the remaining term of the lease.

Both Two Trees and CIT argued that the total lease rejection damages suffered by Two Trees exceeded the statutory cap. Besides lost rent, the damages also included all indirect losses resulting from BTI's lease termination, such

as resale expenses, and, most importantly, Two Trees' inability to satisfy the mortgage. The Bankruptcy Court, however, allowed damages only to the extent of unpaid rent and other carrying costs incurred by Two Trees for the period prior to resale, and disallowed any damages arising from Two Trees' inability to satisfy the mortgage. Thus, the Bankruptcy Court ordered Two Trees to turnover $1,175,995.44, representing the difference between the face amount of the Letter of Credit ($1.6 million) and the allowed amount of Two Trees' lease rejection claim in bankruptcy ($424,004.56). The Bankruptcy Court ruling on damages was affirmed by the District Court on September 30, 2005.

E. ***Circuit Court Appeal***

In deference to finality concerns, the case was not heard by the Eleventh Circuit until both the issues of liability and damages were fully determined through the District Court level. During the pendency of Two Trees' appeal to the Eleventh Circuit, the Fifth Circuit Court of Appeals rendered its decision in *Stonebridge*, *supra*, which squarely addressed the issue of whether a turnover action can be pursued against a landlord to recover excess letter of credit proceeds. In reversing the prior decisions of the bankruptcy and district courts, the Fifth Circuit first recognized that the Independence Principle applies to remove letters of credit from the purview of the bankruptcy, and then correctly held that the statutory cap under 11 U.S.C. § 502(b)(6) can not be invoked affirmatively by a trustee or debtor-in-possession through a turnover if the landlord never files a proof of claim during the bankruptcy case.

Since Two Trees likewise did not file a proof of claim in connection with BTI's bankruptcy case, we argued that the

Eleventh Circuit should follow the approach and rationale of *Stonebridge*, *supra*, to nullify the turnover order relating to the Letter of Credit proceeds. Regrettably, the Eleventh Circuit gave effect to the turnover, only sheepishly noting in a concluding footnote that it believed its decision was not in conflict with *Stonebridge* primarily because the damages cap under 11 U.S.C. § 502(b)(6) was not applied. *In re Builders Transport*, 471 F.3d at 1193, n.12 (App. A at 28a). To the extent that this occurred, it was only due to the Eleventh Circuit's failure to appreciate that Two Trees' indirect damages included losses flowing from the subsequent inability to pay and satisfy the mortgage to CIT due to the loss of the funding mechanism, to wit, termination of the lease. Such indirect damages would have brought Two Trees well beyond the cap. Yet, for substantive purposes, the Eleventh Circuit missed the essence of the *Stonebridge* holding; the provisions of 11 U.S.C. § 502(b)(6) do not create an affirmative right of recovery via a turnover with respect to letter of credit proceeds and, indeed, do not come into play absent the filing of a proof of claim by the landlord. Thus, rather than clarifying matters, the Eleventh Circuit only muddied the waters.

REASONS FOR GRANTING THE PETITION

As stressed earlier, this case presents a vital issue of bankruptcy law and runs flush into an expanding storm of conflicting Circuit Court decisions dealing with the status and disposition of a letter of credit established as a lease security in bankruptcy. The ruling squarely undermines the long-standing view that letters of credit are not impacted by a bankruptcy filing and creates confusion in an area of law that demands absolute certainty and clarity. Indeed, reliance on letters of credit derives from the cardinal principle that

they constitute an expedient and sure method of payment from a solvent party, fully insulated from bankruptcy. Given the unsettled state of the law in this area, this Court's guidance is urgently warranted to announce a rule of law that is consistent both with the pure text of the Bankruptcy Code and the commercial expectations of the real estate industry – namely, that the proceeds of a letter of credit established as lease security are not part of the bankruptcy estate and can not properly be the subject of a turnover action in bankruptcy. To hold otherwise jeopardizes the Independence Principle – "the cornerstone of letter of credit law." *Kellogg v. Blue Quail Energy, Inc.* (*In re Compton Corp.*) 83 F.2d 586, 590 (5th Cir. 1987).

To better appreciate the need for clarity, it is important to canvass the disparate Circuit Court precedents. As noted above, a landlord's damage claim arising from a lease rejection is subject to a statutory cap under 11 U.S.C. § 502(b)(6). Although the plain language of § 502(b)(6) does not speak to how a security deposit should be applied in connection with the cap, the legislative history cites favorably *Oldden v. Tonto Realty Corp.*, 143 F.2d 916 (2d Cir. 1944) for the proposition that to the extent that a landlord has a security deposit in excess of the amount of his claim, the excess comes into the estate. *See* H.R. Rep. No. 95-595 at 353-354, 95th Cong., 1st Sess. 354 (1977), as reprinted in 1978 U.S.C.C.A.N. at 6309 (a lessor "will not be permitted to offset his actual damages against his security deposit and then claim for the balance under this paragraph. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under this paragraph").

Significantly, however, the *Oldden* decision involved a refundable cash security deposited by the debtor/tenant that

was property of the bankruptcy estate. By comparison, a letter of credit does not constitute property of a bankruptcy estate and is not even subject to the automatic stay. *See, e.g. Compton, supra* [The automatic stay does not prohibit a lender from drawing down upon a letter of credit because lender is receiving property of the issuer, not property of the debtor's estate]. Hence, a letter of credit should be treated differently than a cash security for purposes of evaluating a landlord's entitlement to excess proceeds. The existing Circuit Court decisions, however, neither subscribe to a unitary view on this point, nor follow a consistent analytical framework.[1]

The first decision to analyze the relationship between a letter of credit and the Bankruptcy Code's limitation on a landlord's claim was rendered in *Solow v. PPI Enterprises, Inc. (In re PPI Enterprises (US) Inc.)*, 324 F.3d 197 (3rd Cir. 2003). In *PPI Enterprises, supra*, the landlord argued that the proceeds of the letter of credit should be applied to reduce his overall gross damage claim even if it exceeded the statutory cap under 11 U.S.C. § 502(b)(6), based upon the fact that it was paid by a third-party.

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[1] The matter has drawn the interest of a number of commentators and scholars who have expressed differing views as well. *See, e.g.* Luber, *Letters of Credit and 11 U.S.C. § 502(b)(6): The Full Analysis — Why The Fifth Circuit's Decision in In Re Stonebridge is Only Part of the Answer*, 22 Emory Bankr. Dev. J. 679 (2006); St. James, *Oldden, Letters of Credit and Section 502(b)(6)*, 26 Cal. Bankr. J. 307 (2003); Bartell, *The Lease Cap and Letters of Credit: A Reply to Professor Dolan*, 120 Banking L.J. 828 (2003); Berman et al., *Landlords Use Letters of Credit to Bypass the Claim Gap of §502(b)(6)*, 20 Am. Bankr. Inst. J. 16 (2002); Winick, *Tenant Letters of Credit; Bankruptcy Issues for Landlords and Their Lenders*, 9 Am. Bankr. Inst., L. Rev. 733 (2001).

While at least recognizing the existence of the Independent Principle as a countervailing force, the Third Circuit in *PPI Enterprises* ruled that the proceeds should be applied to reduce the landlord's Section 502(b)(6) cap claim. In doing so, however, the Third Circuit relied heavily upon the language of the parties' actual lease which expressly stated that the letter of credit was delivered "in lieu of a cash security". Accordingly, the Third Circuit reasoned that the parties manifested a mutual intention that the letter of credit was tantamount to a cash security. *Id.* at 209. Because the Third Circuit chose to rely on the language of the lease for its holding, it left open whether the Independence Principle would apply under different lease terms to allow a landlord to retain the proceeds of a letter of credit. *Ibid.*

The Ninth Circuit also weighed in on the issue in *AMB Property, L.P. v. Official Creditors for the Estate of AB Liquidating Corp.* (*In re AB Liquidating Corp.*) 416 F.3d 961 (9th Cir. 2005) and ruled that the proceeds of a letter of credit should be applied to reduce a landlord's cap claim without any mention of the Independence Principle. Instead, the Ninth Circuit wrongly reasoned that the letter of credit was identical to a cash security.

In November of 2005, the Fifth Circuit handed down its *Stonebridge* decision which flatly rejected both *PPI* and *AB Liquidator*'s progeny, *In re Mayan Networks*, 306 B.R. 295 (9th Cir. BAP (Cal) 2004). Much like the case here, the debtor in *Stonebridge* was a tenant to a pre-petition lease which provided a letter of credit as a form of security. The letter of credit was collateralized by a certificate of deposit pledged by the tenant to reimburse the paying bank if there was a draw-down by the landlord. After the tenant sought

bankruptcy relief, the underlying lease was deemed rejected by order of the bankruptcy court. In contemplation of the lease rejection, the landlord made a draw under the letter of credit and the paying bank subsequently applied the certificate of deposit for reimbursement of the tenant's obligations.

The bankruptcy trustee was initially successful in bringing a turnover action against the landlord to recover, *inter alia*, the excess proceeds of the letter of credit. The landlord appealed to the Fifth Circuit which reversed on the ground that the landlord never filed a claim in bankruptcy, negating any ability to use the provisions of § 502(b)(6) affirmatively. The Fifth Circuit emphasized that the provisions of § 502(b)(6) only apply to filed bankruptcy claims.

According to the Fifth Circuit, the filing of a proof of claim was an absolute prerequisite and *sine qua non* to any type of recovery under § 502(b)(6): "Stated simply, the claim of a lessor against the assets of the estate is an essential precondition to applying the damages cap at all." *Id.* at 270. The Fifth Circuit expressly rejected the trustee's argument that the letter of credit was subject to a turnover because it was part of a lease security deposit, emphasizing that unlike an avoidance actions, the trustee cannot pursue affirmative recovery of "letter of credit" proceeds under § 502(b)(6):

> "One problematic aspect of this argument is that it converts § 502(b)(6) into a self-effectuating avoiding power that would allow the trustee to bring an adversary proceeding against a lessor who exercises his rights under a letter of credit. This

> departs from the plain language of §502(b)(6), which 'allows only one thing-disallowance of the filed claim to the extent that it exceeds the statutory cap.'"

Ibid.

Moreover, the *Stonebridge* decision is not limited to situations only where damages exceed the statutory cap, but rather stands for the proposition that an analysis under § 502(b)(6) to assess damages vis-à-vis the statutory cap is unnecessary without the filing of a proof of claim by the landlord. In the words of the Fifth Circuit: "*We find, therefore, that a further inquiry into the interpretation of § 502(b)(6) is unnecessary in this case because EOP (the landlord) did not file a claim against the estate.*" *Ibid.* (emphasis supplied).

The *Stonebridge* analysis is not only true to the express language of the Bankruptcy Code, but invalidates the impermissible creation of a *de facto* avoidance power in bankruptcy – not otherwise intended or recognized by Congress – under the guise of a lease rejection claim. Its reasoning and approach is imminently worthy of national application and stands in contrast to the loose construction of the Eleventh Circuit which wrongly allowed the improper use of a turnover device to recover letter of credit proceeds issued by a non-debtor.

It is axiomatic that the issues regarding disposition of letters of credit transcend the parties to this appeal and will invariably arise in numerous other bankruptcy cases. Indeed, it is not a stretch of the imagination to believe that this case implicates the rights and course of dealings by innumerable parties. The existing split among the Circuits is harmful to

real estate and commercial interests and expectations generally, and will impose unnecessary burdens on both landlords and tenants alike. Indeed, without a bright-line rule in the area, landlords will likely be compelled to seek-out multiple, and perhaps unnecessary, forms of alternate security because they can not rely upon the normally assuredness of a letter of credit.

The Court has demonstrated a consistent history of hearing bankruptcy matters to give proper and true statutory construction to various provisions of the Bankruptcy Code. *See e.g., Marrama v. Citizens Bank Of Massachusetts et al.*, __ U.S. __, 127 S.Ct. 1105 (2007) [interpreting right to convert case from Chapter 7 to Chapter 13 - 11 U.S.C. § 706(a) and (d)]; *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) [examining method of calculating interest rate on payments to secured creditor under Chapter 13 plan – 11 U.S.C. § 1325(a)(5)(B)]; *Johnson v. Home State Bank*, 501 U.S. 78 (1991) [determining that mortgage surviving Chapter 7 discharge of debtor's personal liability was a "claim" subject to inclusion in approved Chapter 13 reorganization plan – 11 U.S.C. § 502]; *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) [right to post-petition interest on oversecured tax claims – 11 U.S.C. § 506)].

Review of this case would allow for a similar opportunity to provide badly needed guidance with respect to the scope of statutory rights, which flow out of 11 U.S.C. § 502(b)(6), as well as its proper application to third-party undertakings and letters of credit, which lacks any consistency among the various circuits.

CONCLUSION

For all the foregoing reasons, petitions respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT DATED DECEMBER 5, 2006

UNITED STATES COURT OF APPEALS ELEVENTH CIRCUIT

No. 05-15900.

Dec. 5, 2006.

In Re: BUILDERS TRANSPORT, INC.,

Debtor.

Two Trees, a New York general partnership, David C. Walentas, Jane Walentas, The CIT Group/Business Credit, Inc.,

Plaintiffs-Appellants,

v.

Builders Transport, Inc.,

Defendant-Appellee.

Appeals from the United States District Court for the Northern District of Georgia.

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Before EDMONDSON, Chief Judge, and BIRCH and ALARCON,* Circuit Judges.

BIRCH, Circuit Judge:

This appeal involves a turnover action in bankruptcy pursuant to 11 U.S.C. § 542 filed by the debtor, Builders Transport, Inc. ("BTI"). BTI seeks to recover certain standby letter of credit proceeds that were drawn down and retained by The CIT Group/Business Credit, Inc. ("CIT"), which was the assignee of BTI's lessor, Two Trees, whose two general partners are David C. Walentas and Jane Walentas. The standby letter of credit was created to secure BTI's obligations to Two Trees under a lease agreement that was part of a sale-leaseback transaction. The complicated facts surrounding the sale-leaseback transaction in this case belie a simple conclusion. The letter of credit proceeds, minus certain lessor damages, belong to BTI's estate and should be turned over. We AFFIRM the judgments of the bankruptcy and district courts as to both liability and damages.

I. BACKGROUND

A. *Factual Background*

Most of the facts in this case are undisputed. Quoting liberally and making changes as necessary, we largely adopt the bankruptcy court's statement of the facts in its 30 September 2002 order: BTI was in the trucking business.

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* Honorable Arthur L. Alarcon, United States Circuit Judge for the Ninth Circuit, sitting by designation.

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Its headquarters facility located in Camden, Kershaw County, South Carolina had been constructed with the proceeds of industrial revenue bonds, and BTI leased the facility from Kershaw County until 1995. In that year, the bonds were paid, and BTI was entitled to purchase the property for $1.

BTI's primary lender was CIT. BTI and CIT entered into an amended and restated financing agreement in 1993, which was thereafter amended from time to time, pursuant to which CIT provided to BTI a revolving line of credit, term loan, and letter of credit facilities, secured by virtually all of BTI's assets. In 1990 BTI had written off worthless stock of a satellite messaging company, producing a capital loss carryforward for tax purposes that would expire on 31 December 1995. For several months prior to October 1995, BTI had explored selling and leasing the Camden property.

In the fall of 1995, $1,530,000 of the capital loss carryforward remained unused and could not be used unless BTI had sufficient income in that fiscal year to offset the loss. Stanford M. Dinstein was an officer and director of BTI's parent company, Builders Transport Incorporated ("BTI Parent"), a public company and sole shareholder of BTI, and was apparently the architect of the sale and leaseback plan involving Two Trees; that is, Two Trees would purchase the Camden property and lease it back to BTI.

In considering Dinstein's proposal, officers of BTI and BTI Parent consulted their outside accountants, Ernst & Young, who advised them concerning the structure of the deal and what facts would support the legitimacy of the sale and leaseback and hence the ability to successfully use the

loss carryforward. For tax reasons, Ernst & Young advised against having BTI guarantee the obligations of Two Trees to CIT.

On 5 October 1995, the Board of Directors of BTI Parent met to consider the sale and leaseback deal with Two Trees. At that time, David Walentas was a general partner in Two Trees and Chairman of the Board of BTI Parent, as well as Chairman of the Board of BTI. Walentas did not attend the 5 October 1995 Board meeting, however. Nor did he act on behalf of Two Trees, as one of its general partners, in connection with these transactions. Instead, Dinstein chaired that Board meeting. He also represented Two Trees as its attorney in fact in the sale and leaseback transactions. The Board, with Dinstein abstaining, unanimously approved resolutions authorizing the sale and leaseback transactions between BTI and Two Trees.

The following day, BTI Parent, as the sole shareholder of BTI, by Robert Garner, its corporate secretary, executed a written consent in lieu of a shareholder meeting adopting resolutions on behalf of BTI approving the transactions and authorizing officers to execute and deliver the appropriate documents. That consent, attached as an exhibit to Mr. Garner's affidavit filed on 26 June 2000, states in part: "FURTHER RESOLVED, that it is in the best interest of [BTI] to obtain a letter of credit in the amount of up to $1.6 million in favor of Two Trees . . . securing [BTI's] lease obligations to Two Trees."

The deal closed on or about 11 October 1995. Two Trees purchased the Camden property from BTI for $3.5 million

and leased the property back to BTI. The lease agreement provided for a five-year term, commencing on 12 October 1995, with BTI having the option to renew the lease for four successive periods of five years each at then fair market rent. The lease agreement provided that BTI would obtain a letter of credit to secure its obligations under the lease. On or about 12 October 1995, Dai-Ichi Kangyo Bank ("DK Bank") issued a letter of credit in favor of Two Trees in its capacity as lessor, on behalf of BTI, in the amount of $1.6 million "to support [BTI's] obligation to pay rent and other amounts under the lease."

Two Trees borrowed from CIT the $3.5 million it paid to BTI for the Camden property. In agreements executed by Dinstein, Two Trees secured its obligation to CIT with a mortgage on the Camden property and with an assignment of its interest in the lease agreement with BTI and in the letter of credit issued by DK Bank. The rent paid by BTI went directly to CIT pursuant to a lockbox agreement between CIT and Two Trees. The amount of BTI's monthly lease payment was $37,825, which was the amount of the note payment due from Two Trees to CIT. Had the note of Two Trees to CIT been amortized according to its terms, Two Trees would still have owed CIT in excess of $2,000,000 at the end of the 60-month lease term.

CIT and DK Bank executed a reimbursement agreement, wherein CIT was obligated to reimburse DK Bank for any payments made by DK Bank on standby letters of credit that DK Bank issued at the request of CIT, in its role as assignee of Two Trees. In the event that CIT was obligated to reimburse DK Bank for money paid under a letter of credit issued for

BTI's benefit, the financing agreement between BTI and CIT obligated BTI to reimburse CIT for the same amount. During the course of these transactions, the financial institutions collected their fees associated with the issuance of the letter of credit and related agreements.

On 21 May 1998, BTI Parent, BTI, and related companies filed for Chapter 11 of the Bankruptcy Code. 11 U.S.C. § 101 *et seq.* Subsequent to the petition date, BTI continued for a few weeks to operate the business as debtor-in-possession. Virtually all of BTI's assets secured prepetition debt to CIT and to the CIT Group/Equipment Financing, Inc. With court approval, BTI and CIT companies stipulated to the use of cash collateral by BTI and to the grant of a postpetition security interest in BTI's assets to secure the claims of the CIT companies.

It quickly became obvious to everyone involved in the case that BTI's efforts at reorganization as a going concern could not be successful. BTI conducted a public auction of certain parts of its business on 29 June 1998, and the bankruptcy court approved the sale of those assets to Schneider National, Inc., in an order entered on 10 July 1998. The asset purchase agreement between BTI and Schneider permitted Schneider to occupy the Camden property on a shared use basis with BTI for four months with Schneider to pay 75% of the rent to Two Trees.

On 9 July 1998, CIT, as BTI's lender, sent a notice to DK Bank that BTI's obligations under the lease agreement had been accelerated. On 15 July 1998, DK Bank notified CIT, as the lender to and assignee of Two Trees, that because

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CIT had accelerated the debt of BTI, the letter of credit would expire in 30 days. On 15 July 1998, CIT, as lender to and assignee of Two Trees, submitted to DK Bank a completed "Default Draft" for $1.6 million.

On or about 22 July 1998, DK Bank paid $1.6 million to CIT, as lender to Two Trees, and CIT, as BTI's lender, reimbursed DK Bank in the amount of $1.6 million. On or about 22 July 1998, CIT, as BTI's lender, charged the amount of $1.6 million to BTI's line of credit, which was secured by property of the estate. Also on 22 July 1998, CIT, as lender to Two Trees, used the $1.6 million received from DK Bank, to pay down the debt Two Trees owed CIT.

The sale of assets to Schneider closed on 3 August 1998. At the closing, Schneider, BTI, and CIT executed a termination agreement and a closing statement, which set forth the amount of CIT's secured claim, which included the $1.6 million charge to BTI's line of credit for the reimbursement of DK Bank. CIT received payment of its claim from the purchase price paid by Schneider. CIT released its lien on BTI's assets, with the exception of certain accounts created pursuant to the termination agreement, and the financing agreement between CIT and BTI was terminated.

In October or November 1998, Schneider vacated the Camden property; BTI had previously moved out. On 10 September 1999, Two Trees sold the Camden property to a third party.

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B. *Procedural History*

On 12 October 1999, BTI filed a turnover complaint in the bankruptcy court against CIT, Two Trees, David Walentas, and Jane Walentas ("Appellants"). Count I of the complaint, which is the only one at issue in this appeal, argued that the $1.6 million in proceeds from the standby letter of credit constituted estate property, subject to turnover pursuant to 11 U.S.C. § 542 to the extent the proceeds exceeded Two Trees's allowed lease rejection claim under 11 U.S.C. § 502(b)(6). Appellants argued, *inter alia,* that the letter of credit was instead part of a disguised financing transaction and was not part of the estate and therefore should not be made subject to § 502(b)(6). The disguise may have deceived the IRS, but not the bankruptcy court.

On 30 September 2002, the bankruptcy court entered an order granting partial summary judgment to BTI as to the issue of liability, leaving the issue of damages open. Two Trees, David Walentas, and Jane Walentas filed an interlocutory appeal of that order, and, on 10 June 2003, the United States District Court for the Northen District of Georgia entered an order affirming the district court. On 15 July 2004, the bankruptcy court entered a separate order and judgment in the amount of $1,175,995.44 in favor of BTI against Appellants. The district court affirmed the damages order on 30 September 2005. Appellants then appealed both the liability order and the damages order to our court.

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II. DISCUSSION

This appeal involves two issues: liability and calculation of damages. After examining our jurisdiction and the appropriate standard of review, we address these issues in turn.

A. *Jurisdiction*

"Bankruptcy courts have jurisdiction, by reference from the District Courts, over 'all cases under Title 11 and all core proceedings arising under Title 11, or arising in a case under Title 11.' " *In re Atlanta Retail, Inc.*, 456 F.3d 1277, 1279 (11th Cir.2006) (citing 28 U.S.C. §§ 157(a), 157(b)-(c)). This matter relates to the substantive rights provided by 11 U.S.C. § 542 and related provisions of the bankruptcy code and is therefore a core proceeding arising under Title 11. The district court had jurisdiction to review the bankruptcy court's orders pursuant to 28 U.S.C. § 158(a). We have jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d).

B. *Standard of Review*

The bankruptcy court's findings of fact are reviewed "under the clearly erroneous standard." *In re Fretz*, 244 F.3d 1323, 1326 (11th Cir.2001). "[C]onclusions of law, whether from the bankruptcy court or the district court, are reviewed *de novo*." *Id.* The grant of summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of

law." Fed.R.Civ.P. 56(c). Thus, our review of the bankruptcy and district courts' grants of summary judgment as to both liability and damages is *de novo.*

C. *Liability*

This is a turnover action pursuant to 11 U.S.C. § 542. There are two discernible arguments on appeal with regard to liability under this statute: (1) the standby letter of credit proceeds do not constitute property of the estate under the doctrine of independence; and (2) the standby letter of credit proceeds do not constitute property of the estate under South Carolina contract law. We consider the law regarding § 542 generally before addressing these arguments.

1. *11 U.S.C. § 542*

Under that statute and related sections of the code, a bankruptcy court "may generally order a third party to turn property in its possession over to the debtor's estate if three primary requirements are met." *In re Lewis,* 137 F.3d 1280, 1282 (11th Cir.1998) (citing 11 U.S.C. §§ 362(d)(1), 363(b)(1), 363(e), 542(a)). "First, such property must be 'property of the estate.' Second, at the moment the debtor filed a petition, the debtor must have had the right to use, sell, or lease the property. Finally, upon request, the court must ensure that the third party's interest in the property is adequately protected." *Id.* (citations omitted).

" 'Property of the estate' is defined broadly to include 'all legal or equitable interests of the debtor in property as of the commencement of the case.' " *Id.* at 1283 (citing 11

U.S.C. § 541(a)(1); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204, 103 S.Ct. 2309, 2313, 76 L.Ed.2d 515 (1983) (observing that "Congress intended a broad range of property to be included in the estate" because "reorganization ... would have small chance of success ... if property essential to running the business were excluded from the estate")). While the question of "whether a debtor's interest constitutes 'property of the estate' is a federal question ... the nature and existence of the [debtor's] right to property is determined by looking at state law." *Id.* (quoting *In re Thomas*, 883 F.2d 991, 995 (11th Cir.1989)); *see also Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."). When that state law determination is made, "federal bankruptcy law [then] dictates to what extent that interest is property of the estate." *In re Thomas*, 883 F.2d at 995.

2. *The Doctrine of Independence*

Appellants argue that the common law doctrine of independence removes the proceeds of the DK Bank standby letter of credit from the property of the estate. Even assuming that South Carolina law recognizes this common law doctrine under its adoption of the Uniform Commercial Code, the doctrine of independence would not remove the letter of credit proceeds from the reach of 11 U.S.C. § 542.

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Before addressing the application of the doctrine of independence to the facts in this case, we examine the nature of the standby letter of credit.

> A standby letter of credit transaction is a three-party agreement involving two contracts and the standby letter of credit .... The first party is the account party or customer .... The second party is the issuing institution, usually a bank .... The contract between the issuing party and the account party is one of the contracts involved in the letter of credit .... The third party to a letter of credit transaction is the beneficiary of the letter of credit. The contract between the account party and the beneficiary is one of the contracts involved in a letter of credit agreement. The letter of credit itself, an obligation between the issuer and the beneficiary, is the final prong of a letter of credit transaction.

Resolution Trust Corp. v. United Trust Fund, Inc., 57 F.3d 1025, 1030 (11th Cir.1995).[1]

While the facts in the case are more complicated than most letter of credit transactions, based on the separate agreements and the many roles played by CIT, the basic relationship among the parties under the *Resolution Trust*

1. *Resolution Trust* involved the repudiation of a lease pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), 12 U.S.C. § 1821(e). *Resolution Trust Corp.*, 57 F.3d at 1029. However, we see no reason why its analysis of the nature of the standby letter of credit would not similarly apply in bankruptcy.

framework can be structured as follows. The first party (customer) is BTI. The second party (issuing institution) is DK Bank. The contract between BTI and DK Bank to establish the standby letter of credit, secured by the assets of BTI's estate, is the first contract. The third party (beneficiary) is Two Trees. The lease agreement between Two Trees and BTI is the second contract and governs the rights and obligations between those two parties and the conditions pursuant to which Two Trees can draw down on the letter of credit to satisfy BTI's obligations under the lease. Finally, the standby letter of credit is an obligation between DK Bank and Two Trees, which later assigned its interests in both the letter of credit and the lease agreement to CIT.

Because the standby letter of credit at issue was constructed as an independent obligation between DK Bank and Two Trees, Appellants argue that BTI's claim for the return of the letter of credit proceeds is excluded from the property of the bankruptcy estate. We do not agree. "[T]he doctrine of independence protects only the *distribution* of the proceeds of the letter of credit." *In re Graham Square*, 126 F.3d 823, 827 (6th Cir.1997). As we explained in *Resolution Trust*, "[o]nce the proceeds of a letter of credit have been drawn down, the underlying contracts become pertinent in determining which parties have a right to those proceeds. In other words, an irrevocable standby letter of credit *does not nullify the obligations set forth in the underlying contracts*." 57 F.3d at 1034-35 (emphasis added).[2]

2. We have previously stated that "neither a letter of credit nor its proceeds are property of the debtor's estate." *See In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293, 296 (11th Cir.1988). (Cont'd)

"Rather the letter of credit serves, among other things, to shift the burden of litigation .... [The] beneficiary of the letter of credit holds the stake during the litigation." *Id.* Here, BTI has *not* challenged the distribution of the letter of credit proceeds by DK Bank to Two Trees's assignee, CIT. Rather, it challenges the right of CIT to *retain* the letter of credit proceeds pursuant to the underlying contract between BTI and Two Trees, which in this case is the lease agreement. The doctrine of independence is therefore inapplicable. In the next section, we examine the rights and obligations pursuant to that agreement.

3. *Whether BTI Has "Property" under South Carolina Contract Law*

South Carolina law governs the lease agreement,[3] and we must therefore look first to South Carolina law to determine the nature and existence of BTI's right to the proceeds of the DK Bank standby letter of credit. *See In re Thomas,* 883 F.2d at 995. Under South Carolina law, "[t]here exists in every contract an implied covenant of good faith

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(Cont'd)

However, that particular case involved the claims of a *creditor* with regard to the proceeds of a letter of credit under a 11 U.S.C. § 547(b) preferential transfer analysis. *See generally id.* It did not address the claims of a *debtor* pursuant to a § 542 turnover action, which includes in the property of the estate "all legal or equitable interests of the debtor in property as of the commencement of the case." *See In re Lewis,* 137 F.3d at 1283.

3. Section 35.6 of the lease states that the lease is "governed by and construed in accordance with the laws of South Carolina."

and fair dealing." *Adams v. G.J. Creel & Sons, Inc.*, 320 S.C. 274, 465 S.E.2d 84, 85 (1995). As such, in the absence of any provision to the contrary, there is a duty to return the excess proceeds drawn down from the standby letter of credit that were not used to secure BTI's obligations under the lease. *Cf. Burbach v. Investors Mgmt. Corp. Int'l*, 326 S.C. 492, 484 S.E.2d 119, 120-22 (1997) (recognizing the common law claim of conversion for a landlord's improper retention of security deposit).

In justifying the retention of the entire $1.6 million drawn down from the DK Bank standby letter of credit, Appellants contend that the letter of credit was designed to make up the difference between the actual value of BTI's property and the mortgage between Two Trees and CIT. Thus, according to Appellants, the letter of credit secured not only BTI's obligation to Two Trees under the lease, but also Two Trees's obligations to CIT under the mortgage.

Before we continue, however, we cannot help but note that Appellants devote voluminous attention in their appellate briefs to the issue of whether the lease is a "true lease" or a secured financing arrangement under 11 U.S.C. § 502(b)(6). They repeatedly urge us to recharacterize the lease as a secured financing arrangement under federal common law's "economic realities" test so as to avoid the limitation on lessor damages under § 502(b)(6). Somewhat overlooked, in our judgment, is the legal analysis of liability under 11 U.S.C. § 542. The "economic realities" test pursuant to the § 502(b)(6) recharacterization analysis does not answer the more straightforward question of what rights BTI has to the letter of credit proceeds under *South Carolina* law in a §

542 analysis, which is an antecedent inquiry to any consideration of a limitation on damages under federal law. Moreover, the recharacterization of the lease as a secured financing arrangement, even under South Carolina law, does not necessarily insulate Appellants from liability because property (or at least claims to such property) relating to both a "true lease" and a secured financing arrangement can be subject to turnover pursuant to § 542. *See In re Lewis*, 137 F.3d at 1283 (" 'Property of the estate' is defined broadly to include 'all legal or equitable interests of the debtor in property as of the commencement of the case.' "); *see also* 11 U.S.C. §§ 541, 542. Thus, our primary inquiry under § 542, and without regard to characterization, is what are BTI's rights and obligations under the lease agreement between it and Two Trees.

In determining what these rights and obligations are, we begin with the terms of the leasing agreement itself. Under South Carolina law "[t]he intent of the parties is to be determined *solely* from the language of a contract, if that language is clear and unambiguous." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Havird*, 335 S.C. 642, 518 S.E.2d 48, 50 (1999) (emphasis added). Further, "[a] court should give the terms of an unambiguous contract their plain, ordinary, and popular meaning." *Id.*

The lease agreement provides in section 7.3 that the letter of credit secured the rent and other amounts under the lease:

> 7.3 Support for Payment Obligations. Lessee covenants and agrees that it shall obtain and maintain in effect at all times during the Term, *as*

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> *further assurance of the payment by Lessee of all amount of Rent and other obligations payable by Lessee hereunder,* a standby letter of credit, issued for the account of Lessee or a wholly owned subsidiary of Lessee, for the benefit of Lessor, in an amount available to de drawn at least equal to $1,600,000 or such lessor amount as Lessor or the Facility Mortgagee (as hereinafter defined) may specify, which letter of credit shall, among other things, be assignable for security to the Facility Mortgagee and otherwise be substantially in the form of the standby letter of credit issued by Dai-Ichi Kangyo Bank, Ltd., on or about the Closing Date, in satisfaction of Lessee's obligations pursuant to this Section 7.3.

(Emphasis added).

The lease refers in section 7.3 to the terms of the letter of credit. The letter of credit states the following:

> This Letter of Credit is being issued to you in your capacity as "Lessor" under the Lease Agreement dated as of October 10, 1995 (as amended and in effect from time to time, the "Lease") between you and Builders as "Lessee". *The Credit Amount is intended to support Builders' obligation to pay rent and other amounts under the Lease.*

(Emphasis added).

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Section 15.2 lists an array of remedies available to Two Trees should a default occur. Section 15.2(a) states that if BTI "abandons or vacates" the property, Two Trees "may enter upon and take possession of such Leased Property in order to protect it from deterioration and continue to demand . . . the monthly rentals and other charges provided." Under section 15.2(b), Two Trees can terminate the lease and seek and take possession. Section 15.2(c) provides:

> (c) Lessor may make demand for payment under and apply or retain, as the case may be, the amount then available to be drawn under the standby letter of credit, as its remedy for any damages sustained by Lessor, arising out of termination of the Lease.

Section 15.3 provides:

> 15.3 *Additional Expenses.* In addition to payments required pursuant to subsections (a) and (b) of Section 15.2 above, Lessee shall compensate Lessor for all reasonable expenses incurred by Lessor in repossessing the Leased Property (including any increase in insurance premiums caused by the vacancy of the Leased property), all reasonable expenses incurred by Lessor in reletting (including repairs, remodeling, replacements, advertisements and brokerage fees), all reasonable concessions granted to a new tenant upon reletting (including renewal options), *all losses incurred by Lessor as a direct or indirect result of Lessee's default (including any appropriate action by a Facility Mortgagee)*, and

> a reasonable allowance for Lessor's administrative efforts, salaries and overhead attributable directly or indirectly to Lessee's default and Lessor's pursuing the rights and remedies provided herein and under applicable law.

(Emphasis added).

Appellants argue that these lease provisions, especially the underlined language in section 15.3, demonstrate that the letter of credit was intended to secure the mortgage of Two Trees to CIT, the facility mortgagee. We disagree.

As the bankruptcy court cogently observed in its 30 September 2002 order, this argument fails based on the unambiguous opening text of section 15.3, which provides that the losses referred to in that subsection are *in addition* to payments required in subsections (a) and (b), which requires the payment of rent. "Hence, even assuming that having to pay the note to [CIT] was a 'loss,' that 'loss' and the loss of not receiving rent are the same loss, so that the 'loss' of having to pay the note is not *in addition* to the loss incurred for non-payment of rent. Moreover, Two Trees suffered no 'loss' by having to pay back a loan because it received the proceeds of the loan." Bankruptcy Order (30 Sept. 2002) at 19.

Reviewing the agreements, we can find no provision in the lease or the standby letter of credit that would indicate that the standby letter of credit was intended to secure the mortgage of Two Trees to CIT. Thus, under South Carolina contract law, BTI has a claim to the standby letter of credit

proceeds retained by CIT based on the unambiguous language in the leasing agreement and the letter of credit. *See Merrill Lynch,* 518 S.E.2d at 50.

Even if we were to conclude that these lease provisions were ambiguous, the evidence in the record does not dictate a different result. Under South Carolina law, "[i]f the vital terms of a contract are ambiguous, then, in an effort to determine the intent of the parties, the court may consider probative, extrinsic evidence." *Dixon v. Dixon,* 362 S.C. 388, 608 S.E.2d 849, 852 (2005). In this case, it is undisputed (1) that BTI did not execute and was not liable under the Two Trees mortgage; (2) that BTI did not execute any guaranty agreement under which BTI agreed to serve as guarantor for any debt represented by the Two Trees mortgage; and (3) that BTI did not execute any agreement under which BTI agreed to pay the debt that Two Trees owed to CIT under the Two Trees mortgage. Additionally, Appellants do not contest the bankruptcy court's conclusion that the minutes of the meeting of BTI Parent on 5 October 1995 and the unanimous consent to the resolutions authorizing BIT to enter into the various agreements relating to the lease agreement and sale of the property do not indicate that the letter of credit was intended to secure the mortgage of Two Trees.

On the other hand, Two Trees's primary partner, David Walentas, personally guaranteed the entire debt of Two Trees to CIT and all of the obligations of Two Trees to CIT related to that debt. While it is clear that the purchase price was influenced by the capital loss carryforward, there is no evidence concerning the actual fair market value of the

Camden facility in October 1995. As such, a conclusion that the letter of credit was intended to secure the difference between the actual fair market value and the purchase price is conjecture. Simply put, the record evidence is bereft of any intention *on the part of BTI* to secure the obligations of Two Trees to CIT.

Thus, we conclude that BTI's claim pursuant to the unlawful retention of the proceeds of the letter of credit of satisfies the definition of property[4] for purposes of § 542(a).[5] The next section examines the calculation of Two

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4. The second and third requirements set forth in *In re Lewis* are easily met. As to the second requirement, BTI either had the right to "use" the money at the date of petition, or, at least, the right to use its legal claim to the letter of credit proceeds to effect their return. *See In re Lewis,* 137 F.3d at 1282. As to the third requirement, we conclude that the bankruptcy court adequately protected Appellants' interest in the letter of credit proceeds because, as shown in the section on damages, we affirm the judgment of the bankruptcy court with regard to lessor damages. *See id.*

5. On appeal, Appellants do not contest the conclusion of the bankruptcy court that, under state contract law, Two Trees is liable for any unlawful draw down and retention of the letter of credit proceeds because (1) CIT was its assignee under lease and the letter of credit and (2) Two Trees received the benefit of the proceeds of the letter of credit because they were applied to its mortgage. Furthermore, Appellants also do not contest that CIT, as Two Trees's assignee, was at least subject to the lease's implied covenant of good faith and fair dealing when CIT drew down the letter of credit proceeds. *See* 6 *Am.Jur.* 2D Assignments § 162 ("An assignee is subject to the obligations imposed by the contract when he or she assumes those obligations, either expressly or impliedly.").

Trees's damages under the lease, and therefore the specific amount of the letter of credit proceeds that Appellants are obligated to return to BTI.

D. *Damages*

The proper calculation of damages for BTI under the bankruptcy code, as both Appellants and BTI agree, is to deduct from the $1.6 million proceeds of the standby letter of credit the amount of allowable damages by the lessor Two Trees. However, Appellants contend that the amount of damages incurred by Two Trees under the lease exceeds the $1.6 million letter of credit, and BTI is thereby entitled to nothing. In so doing, they argue that the bankruptcy court erred by concluding that the lease was a "true lease" for the purposes of 11 U.S.C. § 502(b)(6) and therefore subject to the cap on lessor damages therein.

Because the amount of a lessor's damages under a lease agreement also relates to the nature and existence of the debtor's right to property, we must review South Carolina law on contract damages before any subsequent application of federal law. *See In re Thomas,* 883 F.2d at 995. "It is the rule in South Carolina that when a lessee declines to perform his contract, a cause of action immediately arises in favor of the lessor for full damages, present and prospective . . . and the measure of damages is the difference between the rent fixed in the lease and the rental value of the premises for the entire term at the time of the breach, together with such special damages as may have resulted from the breach." *Richman v. Joray Corp.,* 183 F.2d 667, 671 (4th Cir.1950) (citing *Simon v. Kirkpatrick,* 141 S.C. 251, 139 S.E. 614

(1927)). Thus, under South Carolina law, actual damages under the lease include unpaid rent, other agreed upon expenses, and special damages. *See id.* Special damages are defined as "those that may reasonably be supposed to have been in the contemplation of *both* parties at the time of contracting as a probable result of a breach." *Windham v. Honeycutt,* 290 S.C. 60, 348 S.E.2d 185, 187 (1986) (emphasis added). Moreover, the burden is on the party that seeks to recover special damages. *See Jackson v. Midlands Human Res. Ctr.,* 296 S.C. 526, 528, 374 S.E.2d 505, 506 (1988). "If the ... proof is speculative, uncertain, or otherwise insufficient to permit calculation of ... special damages, [the] claim should be denied." *Id.*

Before addressing the damages for unpaid rent and other direct losses under the lease, we address the issue of special damages. Here, Appellants' claim to the entire $1.6 million letter of credit proceeds as special damages, without regard to what the lessor is actually owed under the lease agreement, is speculative. As discussed in the section on liability, there is no evidence in the record that BTI intended for the letter of credit to secure Two Trees's mortgage to CIT. Moreover, sections 5.1 and 8.1 of the lease state that Two Trees remains the owner of the leased property at the end of the lease. Articles I and XXXIV of the lease show that the initial term of the lease was only for five years and BTI had no right to renew the lease at the original rent amount. While the monthly rental payments under the lease equaled the monthly payment on Two Trees's mortgage to CIT, it bears repeating that the time necessary to amortize the mortgage completely was considerably *longer* than the five year lease term. Under such facts, we would be hard pressed to conclude that BTI

"contemplated" that the letter of credit would be used to satisfy Two Trees's mortgage beyond BTI's stated obligations under the lease. *See Windham,* 348 S.E.2d at 187.

Even assuming such a contemplation, Appellants have not provided us with a way to calculate special damages based on when the breach occurred, but instead suggest that any breach at any time during the time of the lease entitles them to $1.6 million because the letter of credit was designed to secure Two Trees's mortgage to CIT.[6] We cannot accept that conclusion. If BTI had performed all of its obligations under the lease throughout the five year term and opted not to renew the lease, Two Trees would not be entitled to the letter of credit because there would be no breach. If BTI had performed all of its obligations under the lease except for the payment of rent for the last month of the term, however, the legal conclusion that Two Trees or its assignee CIT could draw down and retain the entire $1.6 million letter of credit proceeds as special damages because of such breach would be unsustainable. With regard to the proper calculation of special damages for a breach that occurred in the middle of the lease, Appellants unfortunately leave us to our own devices. We decline the challenge.

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6. On appeal, Appellants also do not contest the bankruptcy court's conclusion that section 15.2(c) of the lease, if construed as a liquidated damages provision, would be unenforceable under South Carolina law. *See Moser v. Gosnell,* 334 S.C. 425, 513 S.E.2d 123, 126-27 (1999) ("The test for determining whether a stipulation constitutes a penalty is whether the sum stipulated is so large that it is plainly disproportionate to any probable damage resulting from breach of the contract." (quotations omitted)).

Additionally, Appellants point to no evidence in the record to show that Two Trees was forced to sell the Camden property when it did. Accordingly, any difference between the mortgage price and the later sale price of the Camden property is not properly considered special damages. *See Jackson,* 374 S.E.2d at 506. Neither can we discern any other special damages relating to Two Trees's obligation to pay its mortgage to CIT.

We now turn to unpaid rent and other direct losses under the lease. While the bankruptcy court started its damages calculation from the petition date under a § 502(b)(6) analysis, as opposed to the date under which BTI rejected the lease, which occurred after the petition date and presumably would be the starting point for the lessor damages calculation under South Carolina law (since BTI was current on its obligations under the lease until that date),[7] *see Richman,* 183 F.2d at 671, there is ultimately no difference in the amount of damages that Two Trees is entitled to claim under the lease. Other than a different starting date and the potential application of the § 502(b)(6) damages cap, we see no difference, under the facts in this case, between

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7. Even if we were persuaded that the sale of various assets by BTI constituted an anticipatory breach of the lease under South Carolina law, this event occurred before BTI stopped paying rent and would not change the amount of rent and other direct costs that Two Trees was entitled to under the lease. *See Richman,* 183 F.2d at 671. On appeal, BTI did not make the argument that the improper draw down by Two Trees's assignee CIT constituted a breach of contract by the lessor, thus absolving BTI of its remaining obligations under the lease. *See U.S. Rubber Co. v. White Tire Co.,* 231 S.C. 84, 97 S.E.2d 403, 409 (1956).

the methodology of calculating unpaid rent, other direct losses, and appropriate credits under § 502(b)(6) and under South Carolina law.[8] BTI does not dispute that Two Trees is entitled to $424,004.56, the amount properly calculated by the bankruptcy court under a § 502(b)(6) analysis,[9] and we do not believe that any potential recalculation of lessor damages under state law would alter that amount.

Furthermore, because the lessor damages conceded on appeal by BTI are less than the statutory cap applied under a § 502(b)(6) analysis[10] and because Two Trees and CIT have

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8. Assuming that § 502(b)(6) is properly triggered, we do not suggest in this opinion that a bankruptcy court order must provide a calculation of damages from the date of the breach under state law, and then provide another calculation of damages from the date required under § 502(b)(6). Such a duplicative effort would be unnecessary. As noted previously, once the state law determination is made as to what constitutes property pursuant to § 542, "federal bankruptcy law [then] dictates to what extent that interest is property of the estate." *In re Thomas,* 883 F.2d at 995.

9. This amount is the sum of the total minimum rent due from the date of petition to the date of the sale of property, minus the amount of rent paid during that period, plus the total real estate taxes, insurance, and repair and maintenance costs incurred during that period. The date of petition was 1 June 1998 and the sale occurred on 9 September 1999. Two Trees's actual damage claim is limited to the date of the sale because there can be no claim for damages occurring after the sale of the property, and Appellants do not argue otherwise. *See* 25 *Williston on Contracts* § 66.86 (4th ed.). Applying *de novo* review, we agree with the bankruptcy court's calculations pursuant to § 502(b)(6).

10. The cap under § 502(b)(6) is the greater of one year's rent, or 15%, not to exceed three years, of the rent for the remaining term. (Cont'd)

not proven that the lessor is entitled to anything more, we need not wade into the factor-intensive thicket regarding the proper characterization of this lease agreement as either "true lease" or a secured financing arrangement under § 502(b)(6). As such, we do not address the argument that § 502(b)(6) is inapplicable because Two Trees did not file a claim against the estate. Moreover, that issue was not presented to the district court after the bankruptcy court determined in its damages order that such a filing was not necessary because Two Trees was a secured creditor and, once CIT drew down the letter of credit, Two Trees no longer had a claim. *See Denney v. City of Albany,* 247 F.3d 1172, 1182 (11th Cir.2001) (holding that issues not briefed on appeal are deemed abandoned); *see also In re Walker,* 959 F.2d 894, 896 (10th Cir.1999) (declining to consider bankruptcy issues that were not raised in an appeal to the district court).[11] It bears

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(Cont'd)

Under the lease, one year's rent is $453,900.00, not including other direct expenses that could be considered "rent" for purposes of § 502(b)(6). The bankruptcy court calculated Two Trees's maximum allowable damages for the 15 month/9 day period from the date of petition to the day of the sale as $424,004.56. Because this amount is less than one year's rent under the lease, the statutory cap under § 502(b)(6) is not applicable.

11. Additionally, we need not judge the whether the lease was improperly rejected pursuant to 11 U.S.C. § 365, which applies only to "true leases," *see In re Martin Bros. Toolmakers, Inc.,* 796 F.2d 1435, 1439-40 (11th Cir.1986), because this issue likewise does not affect the amount that BTI's estate is entitled to under 11 U.S.C. § 542. Furthermore, in their appellate briefs, Appellants cite this statute only in the context of the § 502(b)(6) damages calculation.

(Cont'd)

repeating, however, that the turnover action taken by BTI pursuant to § 542 was not predicated on the fact that its lessor's assignee retained funds in excess of the § 502(b)(6) damages cap, but rather on the fact that its lessor's assignee was not entitled to retain the funds pursuant to the underlying lease agreement.[12] In any event, as we have previously concluded, the damages cap under § 502(b)(6) was not applied, and the Appellants have not proven any more lessor damages than those already conceded by BTI. BTI's estate is thereby entitled to $1,175,995.44, which is the difference between the $1.6 million letter of credit proceeds retained by CIT and Two Trees's $424,004.56 damages for breach of the lease.

(Cont'd)

They make no argument that the lease was not terminated by operation of law on 11 November 1998, pursuant to 11 U.S.C. § 365, let alone address the consequences thereof. Thus, that argument is abandoned. *See Denney*, 247 F.3d at 1182.

12. Thus, we believe that our opinion is not in conflict with the Fifth Circuit's recent case, *In re Stonebridge Technologies Inc.*, 430 F.3d 260, 270 (5th Cir.2005) (per curiam), which held that the filed claim of a lessor against the estate was a precondition to applying the damages cap under § 502(b)(6). The court further held that debtor did not have any common law actions against the lessor pursuant to the terms of the lease. *See id.* at 274. In this case, however, BTI has a common law action against Appellants based on the unlawful retention of the letter of credit proceeds, and, moreover, the damages cap under § 502(b)(6) was not applied.

III. CONCLUSION

We conclude that BTI's claim for the return of the standby letter of credit proceeds is "property of the estate" pursuant to 11 U.S.C. § 542. We also conclude that the bankruptcy court's calculation of damages in the amount of $1,175.995.44 is correct, insofar as BTI concedes the amount of lessor damages properly calculated by the bankruptcy court in a § 502(b)(6) analysis, the calculation accords with South Carolina law, and Appellants have not shown that they are entitled to anything more. As such, Appellants are liable to BTI jointly and severally in that amount. AFFIRMED.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA, ATLANTA DIVISION FILED SEPTEMBER 30, 2005

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CIVIL ACTION

1:04-CV-2518-MHS

TWO TREES, a New York general partnership, et al.,

Appellants,

v.

BUILDERS TRANSPORT, INC.,

Appellee.

ORDER

Two Trees, a New York general partnership, together with its general partners, David C. Walentas and Jane Walentas, and CIT Group/Business Credit, Inc. (CIT), appeal from the Bankruptcy Court's Findings of Fact and Conclusions of Law Concerning Damages and Judgment dated July 15, 2004. The Judgment awarded damages to appellee Builders Transport, Inc. (BTI), on its complaint for a turnover of excess proceeds of a $1.6 million stand-by letter of credit established in connection with a prior sale/leaseback transaction involving

BTI's former headquarters in Camden, South Carolina. For the following reasons, the Court affirms the Bankruptcy Court's decision.

Background

On May 21, 1998, BTI petitioned for relief under Chapter 11 of the Bankruptcy Code. At the time of the bankruptcy filing, BTI was engaged in the business of interstate trucking and maintained its headquarters in Camden, South Carolina. For several years prior to the bankruptcy, BTI's operations had been financed by CIT under a combination of revolving credit lines, term loans, and letter of credit facilities pursuant to an Amended and Restated Financing Agreement dated as of May 28, 1993 (Financing Agreement).

In the 1980s, BTI invested in the stock of a satellite messaging company that ultimately proved worthless, generating various write-offs and resulting capital losses. By 1995, BTI still had available to it a capital loss carry-forward of some $1,530,000, which was due to expire at the end of the year. Also in 1995, BTI completed the final payment owed in connection with a local revenue bond offering issued to finance its Camden headquarters. BTI thus effectively owned the property debt-free and saw the opportunity to take advantage of the about-to-expire capital loss carry-forward by entering into a sale-leaseback transaction. The sale of the property would generate immediate cash for the company, and the capital gain would be offset by the capital loss carry-forward.

Appendix B

Accordingly, on October 11, 1995, BTI sold its headquarters property for $3.5 million dollars to Two Trees, a real estate company principally owned by David Walentas, who was also Chairman of the Board of BTI. Two Trees then leased the property back to BTI for a five-year term (the Lease), with BTI having an option to renew the Lease for four successive five-year terms at then current market rent.

Pursuant to a provision in the Lease, BTI obtained a letter of credit in favor of Two Trees from Dai-Ichi Kangyo Bank (DK Bank) in the amount of $1.6 million to secure BTI's obligations under the Lease (the Letter of Credit). DK Bank issued the Letter of Credit at the request of CIT pursuant to CIT's agreement to reimburse DK Bank for any amounts it was required to pay under the Letter of Credit. In turn, BTI was obligated to reimburse CIT any such amounts under the Financing Agreement.

Two Trees financed the entire $3.5 million purchase price with a loan from CIT, which was secured by a first mortgage lien on the property and assignments of Two Trees' rights under the Lease and the Letter of Credit. In addition, David Walentas and his wife Jane personally guaranteed the note to CIT.

The base rent due to Two Trees under the Lease was equal to the debt service due to CIT under the mortgage. Thus, the Lease was conceived and structured as a pass-through payment arrangement. BTI paid rent directly to a lock-box controlled by CIT in an amount pegged to the amount necessary to satisfy Two Trees' principal and interest obligations under the note.

Appendix B

After BTI filed for bankruptcy, CIT, acting as BTI's lender, accelerated BTI's obligations under the Financing Agreement, causing the Letter of Credit issued in favor of Two Trees to expire in 30 days. Prior to the expiration, and now acting as Two Trees' lender and assignee, CIT drew down the entire $1.6 million under the Letter of Credit. In turn, once again acting as BTI's lender, CIT reimbursed DK Bank in the amount of $1.6 million and then charged the $1.6 million reimbursement to BTI's line of credit, which was secured by a lien on BTI's assets. Finally, acting again as Two Trees lender, CIT used the $1.6 million received from DK Bank to pay down the mortgage debt Two Trees owed to CIT. Subsequently, substantially all of BTI's assets were sold to a third-party purchaser, and CIT was paid that portion of the purchase price necessary to satisfy its secured claims against BTI, including the $1.6 million claim for CIT's reimbursement of DK Bank for the proceeds of the Letter of Credit.

The net effect of all this was that BTI funded a pay-down of Two Trees' mortgage debt to CIT in the amount of $1.6 million. BTI contends that this amount greatly exceeded its obligations to Two Trees under the Lease, which was all that the Letter of Credit was intended to secure. Therefore, BTI initiated an adversary proceeding against appellants seeking to recover the excess amount. On September 30, 2002, the Bankruptcy Court granted BTI summary judgment as to appellants' liability on its claim but reserved the issue of damages for trial (Liability Order). Two Trees and David and Jane Walentas appealed, and on July 7, 2003, this Court affirmed the Bankruptcy Court's Liability Order. A

subsequent appeal to the Eleventh Circuit was dismissed due to lack of finality.

The issue of BTI's damages was submitted to the Bankruptcy Court on briefs and stipulated facts. On July 15, 2004, the Bankruptcy Court entered its Findings of Fact and Conclusions of Law Concerning Damages and Judgment finding that Two Trees, David and Jane Walentas, and CIT were jointly and severally liable to BTI in the amount of $1,175,955.44 (Damages Order). Two Trees and David and Jane Walentas appealed the Damages Order on July 23, 2004. CIT appealed both the Damages Order and the Liability Order on July 26, 2004.[1]

Discussion

Appellant CIT first asks the Court to reconsider its July 7, 2003, affirmance of the Bankruptcy Court's Liability Order. CIT argues that the Lease was not a true lease but a financing arrangement, and that there is therefore no cap on damages for breach of the Lease. CIT also argues that no liability exists because, under the "independence principle" governing letters of credit, a letter of credit is viewed as property of the issuing bank and not as property of a debtor's bankruptcy estate. The Court considered and rejected both of these arguments in its previous Order. *See* Order of July 7, 2003, at 7-10, 11-13. CIT has not demonstrated any new precedent,

1. Briefing of the appeal was completed on October 18, 2004, but due to an oversight, the case was not submitted to the Court for a decision. On August 4, 2005, after this oversight was discovered, Judge Cooper, to whom the case had been assigned, transferred the case to the undersigned because it was related to the prior appeal.

newly discovered evidence, or clear error, which would justify reconsideration of the Court's previous Order. Therefore, the Court denies CIT's request for reconsideration.

The Two Trees appellants argue that the Bankruptcy Court improperly awarded BTI judgment against them, because the acts and decisions concerning retention of the Letter of Credit were made by CIT and CIT alone. This argument is without merit for two reasons. First, the Two Trees appellants did not raise this argument either before the Bankruptcy Court or on their first appeal to this Court. Second, there is no dispute that the $1.6 million proceeds of the Letter of Credit were applied to reduce the debt of Two Trees to CIT. Thus, Two Trees received the benefit of the proceeds from the Letter of Credit by having its debt reduced. The fact that the proceeds did not pass through Two Trees hands does not alter the fact that the proceeds directly benefitted Two Trees.

Finally, appellants argue that the Bankruptcy Court erred in calculating damages. All parties agree that BTI's damages should be calculated by taking the $1.6 million proceeds of the Letter of Credit and subtracting the amount of Lease damages allowed by the Bankruptcy Code. The parties disagree, however, on the amount of Lease damages allowed by the Bankruptcy Code.

The Bankruptcy Court calculated the actual Lease damages to be $424,004.56. This amount is the sum of the total minimum rent due from the date of the petition to the date of sale of the property, less the aggregate amount of rent paid ($363,641.25); plus the total real estate taxes,

insurance, and repair and maintenance costs incurred during the same time period ($60,363.31). Subtracting this amount from $1.6 million, the Bankruptcy Court calculated BTI's damages to be $1,175,995.44 and entered judgment accordingly.

The Two Trees appellants claim that the Bankruptcy Court erred in not fully enforcing their indemnification rights or allowing indirect damages and in not allowing resale expenses as part of Two Trees' actual damages. CIT argues that the actual Lease damages include the unpaid balance of the loan obtained by Two Trees from CIT and thus exceed $3 million. Since this amount exceeds the statutory cap set out in section 502(b)(6) of the Bankruptcy Code, CIT contends that the allowable Lease damages should be fixed at the statutory cap, which it contends is $676,978.37.

After a de *novo* review of the record, the Court concludes that the Bankruptcy Court's calculation of damages is correct and that appellants' arguments are without merit. Accordingly, the Court affirms the Bankruptcy Court's decision.

Appendix B

Summary

For the foregoing reasons, the Court AFFIRMS the Bankruptcy Court's Findings of Fact and Conclusions of Law Concerning Damages and Judgment dated July 15, 2004.

IT IS SO ORDERED, this 30th day of September, 2005.

s/ Marvin H. Shoob, Senior Judge
United States District Court
Northern District of Georgia

APPENDIX C — FINDINGS OF FACT AND CONCLUSIONS OF LAW CONCERNING DAMAGES DATED JULY 15, 2004

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

JOINTLY ADMINISTERED UNDER
CASE NO. 98-68798

CHAPTER 11

JUDGE MASSEY

ADVERSARY NO. 99-6480

IN RE:

BUILDERS TRANSPORT, INC., et al.,

Debtors.

BUILDERS TRANSPORT, INC.,

Plaintiff,

v.

TWO TREES, a New York general partnership, DAVID C. WALENTAS, JANE WALENTAS and THE CIT GROUP/ BUSINESS CREDIT, INC., a New York corporation,

Defendants.

Appendix C

FINDINGS OF FACT AND CONCLUSIONS OF LAW CONCERNING DAMAGES

Builders Transport, Inc. ("BTI"), the Plaintiff in this adversary proceeding and the Debtor in the above-referenced Chapter 11 case, seeks a judgment against Defendants for damages arising from the misapplication of funds received by Defendant The CIT Group/Business Credit, Inc. ("CITBC"), as agent for Defendant Two Trees resulting in CITBC overcharging the estate on its own claim against the Debtor. In an Order entered on October 4, 2002, this Court determined the issue of liability in favor of Plaintiff Defendants Two Trees and the Walentas (the "Two Trees Defendants") unsuccessfully appealed that Order to the United States District Court. They then appealed to the Court of Appeals for the Eleventh Circuit, which determined that it lacked jurisdiction to review the District Court's non-final order affirming this Court's October 4, 2002 Order. Pending the resolution of the appeal, this Court deferred holding a trial on the issue of damages and on remaining disputes framed by other counts of the complaint. The parties have now settled all other remaining disputes except the amount of damages owed to Plaintiff on the claim as to which the Court found Defendants liable.

The Court entered a Consolidated Pre-trial Order on March 15, 2004 (document no. 315) submitted by the parties in which they stipulated relevant facts necessary to decide the issue of damages without the need for a trial. Included in this stipulation was the stipulation of facts filed by the parties on June 20, 2000 (document no. 72). The parties submitted exhibits as to which there was no objection to their admission.

Appendix C

The only one they referred to in their trial briefs was the lease agreement, marked as Plaintiff's Exhibit 1 and CITBC Exhibit 2.

In a nutshell, this dispute arises out of a sale and leaseback transaction in the fall of 1995 in which BTI sold its facility in Camden, South Carolina to Two Trees and leased it back pursuant to the terms of a lease agreement dated as of October 11, 1995 (Plaintiff's Exhibit 1), having a five-year term ending on October 1, 2000, renewable at BTI's option. The purpose of the transaction was to create a profit so that BTI could use an otherwise expiring loss carry-forward and thereby gain some needed liquidity by sheltering all of the purchase price. The transaction was hardly arms-length, and there is no evidence concerning the actual fair market value of the Camden facility in October 1995.

Two Trees did not have the funds to pay the purchase price of $3,500,000 and borrowed those funds from CITBC. Defendant David Walentas, a general partner of Two Trees, was the Chairman of BTI at the time. CITBC was BTI's primary lender and had a security interest in virtually all of BTI's property to secure various loans.

To secure BTI's obligations to Two Trees under the lease, Debtor, through the help of CITBC, obtained a letter of credit from Dai-Ichi Kangyo Bank ("DK Bank") in the amount of $1,600,000. Two Trees assigned that letter of credit to CITBC as collateral for the loan to it made by CITBC. BTI's assets indirectly secured the letter of credit because CITBC agreed to reimburse DK Bank in the event that the letter of credit was called, and BTI agreed that CITBC could charge its collateral for the amount of any such reimbursement.

Appendix C

BTI filed bankruptcy on May 26, 1998. The Debtor continued operations for a few weeks but ultimately ceased operations and auctioned certain of its assets in July 1998. The winning bidder was Schneider International, Inc. The Court authorized the Debtor to pay CITBC's secured claim from the proceeds realized from the sale of assets at the closing of the sale to Schneider. The issue of the amount of that claim was reserved

In July 1998, CITBC, without informing the Court or the Debtor and in violation of the automatic stay, set in motion a series of events, like a row of falling dominoes, that resulted in the payment of $1,600,000 to CITBC as agent for Two Trees and a corresponding increase in the amount of CITBC's secured claim against the Debtor. The Debtor paid that increased claim at a closing of the sale of assets to Schneider in early August 1998. In the October 4, 2002 Order, this Court held that the letter of credit secured only Two Trees' allowable claim arising under the lease agreement, the amount of which neither Two Trees nor CITBC nor any other person could have known at the time because the Debtor had neither assumed nor rejected the lease agreement.

The last step in resolving this dispute is to determine the amount of Two Trees' allowable claim secured by the letter of credit, The difference between $1,600,000 and the allowed amount of Two Trees' claim is the amount of Plaintiff's damages.

An unexpired lease is a type of executory contract with respect to which a bankruptcy court may permit the debtor either to assume or to reject, as provided in section 365 of

the Bankruptcy Code. To assume an unexpired lease, a trustee (or debtor in possession in a Chapter 11 case: *see* 11 U.S.C. § 1107) must cure any default and give adequate assurance of future performance. 11 U.S.C. § 365(a) and (b). A trustee may reject a lease either by obtaining an order permitting it to reject or by not assuming it within the deadline prescribed in section 365, including any extension of that deadline ordered by the bankruptcy court.

The effect of rejection under section 365(g) is that the lease is deemed breached by the debtor immediately before the petition date. This means that a landlord's allowed claim for damages is deemed to be a prepetition claim, even though the landlord in fact incurred the damages postpetition. *In re Financial News Network, Inc.*, 149 B.R. 348, 350 (Bankr. S.D.N.Y.1993) ("The result of deeming a post-petition breach to have occurred prepetition is, absent security, to give the non-debtor party a general unsecured claim.") If the obligations of the lessee under a rejected lease are secured, the rejection of the lease gives rise to a prepetition secured claim, but the allowed amount of such a secured claim is governed by section 502(b)(6). *See* October 4, 2002 Order, pp 10-11.

In this case, the Court extended the time within which BTI could assume or reject the lease, and the last such extension was through November 10, 1998. The Debtor did not assume the lease; consequently, pursuant to section 365(d) of the Bankruptcy Code, it was deemed to have rejected the lease on November 11, 1998.

Appendix C

The Bankruptcy Act provided beginning in 1933, and the Bankruptcy Code, which replaced the Bankruptcy Act in 1979, provides, for the limited allowance of the claim of a landlord for damages resulting from the termination of a lease. The applicable provision in the Bankruptcy Code is section 502(b)(6). For an excellent discussion of the prior law and the policy concerns leading to the present provision limiting claims of landlords, *see In re Best Products Co., Inc.*, 229 B.R. 673, 675-76 (Bankr. E.D. Va. 1998).

Section 502(b)(6) provides:

> (b) Except as provided in subsections (e)(2), (f), (g), (h) and (I) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that —
>
> > (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds —
> >
> > > (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of —

> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates[.]

The exceptions stated at the beginning of subsection (b) are not applicable here.

Rejection does not terminate a lease for state law purposes in the sense of terminating the rights and duties of the parties as to future performance so as to eliminate a landlord's claim to future rent. Rather, the meaning of the word "termination" in section 502(b)(6) is a matter of federal law. Rejection of a lease by a trustee or debtor in possession under section 365 of the Bankruptcy Code is the equivalent to "termination" as that team is used in section 502(b)(6). *In re SKA! Design, Inc.*, 308 B.R. 777 (Bankr. N.D. Tex. 2004). As COLLIER ON BANKRUPTCY points out,

> Damages under section 502(b)(6) are based upon the termination of the lease. Whether and when a lease has terminated is a matter to be determined by the courts, for not all events result in termination within the meaning of section 502(b)(6). Indeed, the Code prevents the

> enforceability of *ipso facto* termination clauses in leases based upon (1) the insolvency or financial condition of the debtor, (2) the commencement of a case or (3) the appointment or taking possession by a trustee or a custodian before the filing of the petition commencing the case. Obviously, the rejection of a lease under section 365 is equivalent to a termination by breach, but this is not the only way that a lease may be terminated.

4 COLLIER ON BANKRUPTCY ¶ 502.03[7][b], at 502-41 (15th Ed. Rev. 2003) (footnote omitted).

If "termination" within the meaning of section 502(b)(6) did not occur by reason of rejection of a lease but required termination pursuant to the terms of the lease or state law, it would have been pointless to have included section 502(b)(6) in the Bankruptcy Code, because landlords could easily draft leases to avoid its impact by not exercising an exclusive right of termination under state law, while preserving the right to collect all future rent. Defendants do not contend that the lease agreement between Two Trees and BTI was not terminated by its rejection within the meaning of section 502(b)(6). The lease itself states in section 15.2(c) that the Lessor may apply for the amount available under the letter of credit as "its remedy for any damages sustained by Lessor, arising out of the termination of the Lease," implying that taking the step of drawing down on the letter of credit would occur only after termination under state law. Because CMG as Two Trees' assignee drew down on the letter of credit, the Lessor arguably terminated the lease, although such

termination would have become effective only after the Debtor rejected it. Plaintiff did not make this argument.

Section 502(b)(6) begins by stating that the entire claim of a landlord is allowed and then limits the claim insofar as the claim is for "damages resulting from the termination of a lease of real property." Thus, analysis of a claim arising from a breach of a lease of real property is a two step process. The first step is to determine the total damage claim, divided into two components: (1) the damages that did not result from termination of the lease and (2) the damages that did result from termination of the lease. The second step is to determine whether the claim for damages resulting from termination exceeds the sum of "rent reserved" for the applicable time period plus unpaid rent on the earlier of the petition date or the surrender or repossession date.

With this background, the Court now turns to the stipulated facts, the contentions of the parties and the resolution of each of those contentions.

The parties stipulated the following facts as part of the pre-trial order entered on March 15, 2004. The lease agreement provided for a five-year initial term commencing on October 12, 1995 and ending on October 31, 2000. The lease provides "Minimum Rent of $37,825.00 per month or $453,000.00 annually. The annual real estate taxes on the Camden facility were $35,588.62. The annual insurance premium on the facility was $6,458.00. The annual repair and maintenance cost with respect to the facility was $8,500.00. The Debtor made three rent payments of $37,825.00 each for the months of June, July and August

2002. Following the sale to Schneider, Schneider made several payments with respect to the lease beginning in August and ending in December 2002 that totaled $101,606.25. On September 9, 2003, Two Trees sold the Camden facility and paid a brokerage commission of $144,450.00, transfer taxes and recording costs of $6,495.00, and $9,718.00 in attorney's fees. Two Trees has also incurred and paid $72,952.81 in legal fees in connection with this adversary proceeding. Although there is no stipulation with regard to when the facility was vacated, there is apparently no dispute that the Debtor surrendered the facility no later than November 11, 1998.

The Court determined in the Order entered on October 4, 2002 that the letter of credit issued by DK Bank secured only BTI's obligations under the lease. The Debtor concedes in its brief filed on March 31, 2004 (document no. 138) that it owed Two Trees Minimum Rent totaling $453,900 for the rental periods after the petition date and September 10, 1999, when Two Trees sold the Camden tactility. From that total, it subtracts $215,081, which is the aggregate amount (rounded oft) paid on the lease by the Debtor and Schneider during the pendency of the case prior to rejection. The difference of $238,819, the Debtor contends, is the amount of Two Tree's allowable claim. CITBC and the Two Trees Defendants each calculated damages in a higher amount. Before addressing Defendants' contentions, the Court will first address the question of who has the burden of proof.

Neither the Bankruptcy Code nor the Bankruptcy Rules provide for an allocation of the burden of proof in the

circumstances we have here. As a general proposition, it is the creditor who bears the ultimate burden of proving its claim against the estate. *In re Allegheny Intl, Inc.*, 954 F.2d 167, 173-74 (3d Cir.1992) ("If the objector produces sufficient evidence to negate one or more of the sworn facts in the proof of claim, the burden reverts to the claimant to prove the validity of the claim by a preponderance of the evidence.") Cf., *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 21, 120 S.Ct. 1951, 955 (2000) ("[T]he burden of proof is an essential element of the claim itself; one who asserts a claim is entitled to the burden of proof that normally comes with it") The Court holds that Defendants have the burden of proving the amount of the claim allowable under section 502(b)(6) above the amount of the claim that Debtor concedes.

(Two Trees in fact did not file a proof of claim, but as a secured creditor it was not required to do so. Once CITBC drew down the entire letter of credit, Two Trees no longer had a claim. Under these circumstances the filing of a proof of claim and a formal objection is not a prerequisite to the applicability of section 502(b)(6) to the process of determining the amount of Two Trees' allowable claim at the time CITBC drew down the letter of credit. Defendants have conceded as much by not contending otherwise.)

Damages for breach of a lease by a tenant that files bankruptcy can occur in one or more of three time periods: prepetition, postpetition but pre-rejection and post-rejection. A claim for prepetition rent is not limited by section 502(6)(6). *In re Vause*, 886 F.2d 794, 798-99 (6th Cir. 1989). 4 COLLIER ON BANKRUPTCY ¶ 502.03[7][e], at 502-44-45 (15th

Ed. Rev. 2003). The parties agree that Two Trees had no claim for damages arising out of a breach that actually occurred prior to the petition date. They have stipulated that BTI had paid all rent that had come due as of the petition date. Defendants have not asserted any other claim arising from a breach of the lease prior to the petition date (other than its claim arising out of the rejection of the lease, which is deemed to have arisen prepetition).

A claim for breach of a lease arising postpetition but pre-rejection is not subject to section 502(b)(6) but is instead treated as a first priority administrative claim pursuant to sections 365(d)(3) and 507. CITBC contends that Two Trees has a small non-termination claim for rent that came due postpetition and pie-rejection. The Court agrees. Rent first came due after the filing of the petition on June 1, 1998. The Debtor rejected the lease on November 11, 1998, after rent for that month came due on November 1. There is no evidence that the Debtor had possession of the premises after November 1998. Hence, for that six-month period, the Debtor owed Minimum Rent of $226,950 ($37,825 per month times 6 months). As already mentioned, the Debtor and its subtenant, Schneider, paid rent totaling $215,081.25. The difference of $11,86825 is an administrative expense for which Two Trees has a claim under the lease and section 365(d)(3) of the Bankruptcy Code, as CITBC contends.

The Debtor argues that it ceased to occupy the premises after August 1998 and hence derived no benefit from it after August and that Schneider vacated the premises on November 11, 1998. (There is no evidence to support the contention that the Debtor derived no benefit from the use of the property

by Schneider; indeed, part of the bargain with Schneider was that the Debtor would not reject the lease while Schneider used the property to collect the assets it bought.) The Debtor's argument that it derived no benefit from the premises after August 1998 misses the point that the right of a landlord to insist on timely performance of all obligations under a lease prior to its rejection is hardwired in section 365(d)(3), whether or not the debtor in possession or trustee uses the property.

All of the damages asserted by the Defendants, with the exception of the administrative claim in the amount of $11,868.75, occurred after the rejection of the lease on November 11, 1998. The damages claimed are for breach of the covenants (1) to pay Minimum Rent of $37,825 per month, beginning on December 1, 1998, (2) to pay ad valorem real property taxes and insurance premiums, (3) to repair and maintain the premises and (4) to indemnify Two Trees for any damages it suffered as a result of any other breach of the lease. With regard to the indemnity claim, all Defendants contend that Debtor's breach of the lease injured Two Trees in the amount of expenses incurred by Two Trees in selling the Camden facility in September 1999, and Two Trees further contends that its damages include attorney's fees incurred in defending this adversary proceeding.

Two preliminary issues must be resolved before turning to the contentions of the parties and the proper calculation of each component of Two Trees' allowable claim for damages. These issues are the choice of the applicable law on damages for breach of the lease and what that law requires a landlord to prove in order to establish damages. The lease agreement contains no choice of law provision.

Appendix C

Federal courts have used differing approaches to choice of law issues in cases not involving diversity jurisdiction. *See, e.g., In re Vortex Fishing Systems, Inc.*, 277 F.3d 1057, 1069 (9th Cir. 2002) ("In a bankruptcy case, the court must apply federal choice of law rules. . . . Federal choice of law rules follow the approach of the Restatement (Second) of Conflict of Laws"); *Accord, Medical Mut. of Ohio v. deSoto*, 245 F.3d 561, 570 (5th Cir. 2001); *In re Merritt Dredging Co., Inc.*, 839 F.2d 203, 205-206 (4th Cir. 1988) (in bankruptcy, law of forum state applies); *accord, In re Gaston & Snow*, 243 F.3d 599 (2nd Cir. 2001). Under either of these approaches, the result is the same.

The Restatement's approach is to weigh various contacts and interests of the states whose laws might arguably apply. South Carolina is the state where the lease agreement was made and was to be performed, and the premises are located there. If one looks instead to Georgia as the state in which this Court sits, its conflicts rules also point to South Carolina. *See Boardman Petroleum, Inc. v. Federated Mut. Ins. Co.*, 135 F.3d 750, 752 (11th Cir.1998) ("Georgia does not have a statutory choice-of-law rule, but in contract cases, it follows the traditional doctrine of *lex loci contractus:* contracts are 'governed as to their nature, validity and interpretation by the law of the place where they were made' unless the contract is to be performed in a state other than that in which it was made." (footnote omitted)). Hence, the applicable law is the law of South Carolina.

A lease agreement is simply a type of contract. Under South Carolina law, "damages recoverable for breach of contract must either flow as a natural consequence of the

breach or must have been reasonably within the parties' contemplation at the time of the contract. *Manning v. City of Columbia*, 297 S.C. 451, 377 S.E.2d 335 (1989)." *Hawkins v. Greenwood Development Corp.*, 328 S.C. 585, 595, 493 S.E.2d 875, 880 (S.C. App.1997).

> The burden of proving damages for breach of a contract rests on the plaintiff. *Baughman v. Southern Railway Co.*, 127 S.C. 493, 121 S.E. 356 (1924). Where a plaintiff seeks special damages in addition to his general damages, he must plead and prove both the fact of damage and the amount of damage. *Kline Iron & Steel Co. v. Superior Trucking Co.*, 261 S.C. 542, 201 S.E.2d 388 (1973). If the plaintiff's proof is speculative, uncertain, or otherwise insufficient to permit calculation of his special damages, his claim should be denied. *See Piggy Park Enterprises, Inc. v. Schofield*, 251 S.C. 385, 162 S.E.2d 705 (1968).

Jackson v. Midlands Human Resources Center, 296 S.C. 526, 528, 374 S.E.2d 505, 506 (S.C. App. 1988).

All of the parties agree that Two Trees has a termination claim for Minimum Rent following the rejection of the lease. That is all they agree on. As to virtually every other aspect of the calculation of the claim, each party has a different approach.

The Debtor and the Two Trees Defendants computed the total damages beginning on the petition date and ending on the date on which Two Trees sold the Camden facility. The

Debtor calculated the Minimum Rent for a 15-month period. Plaintiff's Trial Brief, p. 8 (document no. 138). The Two Tires Defendants calculated the Minimum Rent for a period of "17 months rounded," beginning on May 21, 1998 and ending on September 10, 1999. Two Trees' Trial Memorandum of Law, p. 13 (document no. 140). (The September 10 date is an error, the parties stipulated the sale took place on the 9th.) CITBC used a 12-month period without any reference to dates. CITBC Trial Brief, p. 7 (document no. 139).

The Court concludes that the Debtor and the Two Trees Defendants have the correct approach (where, as here, the allowed claim is fully secured), but they used the wrong arithmetic. Because rent was due on the first day of the month and there was no prepetition default, the first month during which rent was due after filing was June. Two Trees held a claim for rent for 15 months from June 1, 1998 through August 31, 1999 and for the first 9 days of September 1999. Both Plaintiff and the Two Trees Defendants based their gross damage calculations with respect to rent on the period between the petition date and the sale date in September 1999. Defendants produced no evidence to show that Two Trees suffered any damage for nonpayment of rent after it sold the Camden facility which its approach to damage calculation concedes. A landlord is not entitled to collect rent or otherwise enforce a lease against a tenant for damages occurring after the landlord sells the premises. WILLISTON ON CONTRACTS, § 66:86, vol. 25, pp. 41-42 (4th Ed. 2002). Hence, the September 1999 rent must be prorated.

Therefore, the total Minimum Rent for the period beginning on June 1, 1998 and ending on September 9, 1999

was $578,722.50, which is the sum of 15 months' full rent amounting to $567,375.00 plus 9130 of the rent for September 1999 amounting to $11,347.50. Both Plaintiff and the Two Trees Defendants agree that from the total Minimum Rent claim, one must subtract the sum of $215,081.25, which was the aggregate amount of rent paid by the Debtor and Schneider during 1998. Subtracting $215,081.25 from $578,722.50 yields $363,641.25, which is the amount of damages Two Trees suffered as a result of the breach of covenant to pay Minimum Rent. (Note that this figure includes the unpaid portion of administrative rent discussed above. To see that this is so, add the administrative rent claim of $11,868.75, which, if paid, would have brought the Debtor current through November 1998, to (A) $340,425, which was the rent for the period of December 1, 1998 through August 31, 1999 (9 months x $37,825 = $340,4251, and (B) $11,347.50 for 9 days in September; the result is $363,641.25.)

With respect to real estate taxes, insurance and repair costs, the parties also took different approaches. Plaintiff and CITBC used the amounts stipulated for these expenses for one year and agree that those amounts are obligations of the Debtor under the lease, although Plaintiff contends that these items are not rent within the meaning of section 502(b)(6). The Two Trees Defendants calculated a portion of this expense over a 15-month period, based on the annual expense figures. The Debtor does not contend that Two Trees did not pay these types of expenses. Nor does it contend that the Debtor paid them during the pendency of the case.

Appendix C

In their brief, the Two Trees Defendants calculated the amount of damages for unpaid property taxes at $46,167.21, showing $32,588.62 as the annual figure instead of the stipulated figure of $35,588.62, for a 15-month period, which also apparently included the last 11 days of May 1998 and 10 days in September 1999. (Their arithmetic is opaque.) They contended that the damages for insurance premiums totaling $6,458.00 annually and repair and maintenance costs amounting to $8,500.00 annually should be rounded off to $15,000. (Two Trees' Trial Memorandum of Law, pp. 13-14.) (document no. 140).

The Court concludes that the correct figure for these expenses in determining total damages is $60,363.31, which is the sum of (A) $45,363.31 for real estate taxes, consisting of the sum of (x) $44,485.78 for the 15-month period (15/12 x $35,588.62) and (y) $877.53 for the 9-day period (10/365 x $35,588.62) and (B) $15,000 for insurance premiums and repair and maintenance costs through the sale date. Defendants proved no more and, as to the insurance and repair expenses, asserted no figure greater than $15,000.

The remaining issue is whether Two Trees has a claim for damages measured by the expenses incurred by Two Trees in selling the Camden facility in September 1999 and in defending this action. In asserting this damage claim, Defendants rely on section 7.3 of the lease which wired BTI to obtain and maintain a letter of credit to assure payment of "rent and all other obligations payable by Lessee hereunder." The other obligations as to which BTI "indemnified" Two Trees included "all direct and indirect losses incurred as a result of Lessee's defaults" as set forth in section 15.3 of the

lease agreement. Finally, they point to Article XXII of the lease in which BTI agreed to

> protect, indemnify, save harmless and Defend Lessor from and against all liabilities, obligations, claims, damages, penalties, causes of action, costs and expenses (including reasonable attorneys' fees and expenses) to the extent permitted by law imposed upon or incurred by or asserted against Lessor by reason of: . . . (c) any Impositions (which are the obligations of the Lessee to pay pursuant to the applicable provisions of this Lease), (d) any failure on the part of the Lessee to perform or comply with any terms of this Lease. . . . Lessee's liability for a breach of the provisions of this Article shall survive a termination of this Lease.

The "indemnified" damages claimed by Two Trees as set forth in the Consolidated Pre-trial Order and in its brief fall into two categories: sale expenses totaling $130,663 incurred on the sale of the Camden facility in September 1999 and legal fees totaling $72,952.81 incurred in defending this adversary proceeding. The sale expenses include a brokerage commission, state and county recording taxes and legal fees. (The brokerage commission is stated to he $114,450 in the portion of the Pre-trial Order dealing with Two Trees' contentions, which is a part of a damage figure mentioned in its brief, but the stipulated facts show the commission to have been $144,450, which is the number used by CITBC in its calculation of damages. The Court assumes the lower figure is an error.)

Appendix C

Defendants produced no evidence whatsoever to show that these expenses were "damages" resulting from a breach of the lease; rather, they assume and assert without explanation or analysis that having to pay those expenses constitutes damages "by reason of" a breach of the lease.

The sale expenses incurred by Two Trees in selling the Camden facility cannot be properly characterized as "damages." Those expenses merely reduced the amount of money that Two Trees received from the sale. It incurred those expenses because it elected to sell the property under the terms and in the manner that it chose. Defendants failed to show that Two Trees would not have incurred the same expenses had there been no breach of the lease and had it elected to sell the property. They offered no evidence whatsoever to show that Two Trees was forced to sell the Camden facility. Thus, as to those expenses it failed to prove "the fact of damage." *Jackson v. Midlands Human Resources Center, supra.*

Defendants failed to introduce any evidence that incurring expenses of the sale "either flow[ed] as a natural consequence of the breach or [was] reasonably within the parties contemplation at the time of the contract." *Manning v. City of Columbia, supra.* There is no evidence that Two Trees had to use a broker or an attorney to sell the Camden facility or had to pay transfer taxes as a result of the breach of the lease by the Debtor. If Two Trees sold the property because it needed money to pay down its debt to CITBC, it failed to prove that fact. The debt owed by Two Trees to CITBC did not arise because the Debtor breached the lease. If Two Trees used the proceeds of the sale to pay down its

debt to CITBC, the sale itself could not have damaged Two Trees. From the standpoint of its balance sheet, it reduced its assets by the net fair value of the property and reduced its liabilities by a like amount.

For such expenses to be recoverable for breach under South Carolina law, Defendants had to prove that incurring such expenses was within the contemplation of the parties at the time the lease was negotiated. *Manning v. City of Columbia, supra.* The lease provides in section 15.3 that the Lessee would be responsible for brokerage fees inclined in reletting the property to a new tenant, but the lease nowhere refers to a sale of the property, giving rise to an inference that the parties never intended such expense to be considered damages for a breach. Defendants introduced no evidence showing that the parties to the lease intended, or even contemplated the possibility, that expenses incurred by the landlord in selling the property after a breach of the lease would constitute damages resulting from that breach.

The Two Trees Defendants also presented no evidence to show that the breach of the lease caused Two Trees to incur attorneys' fees in defending this action or that such fees naturally resulted from the breach or that incurring such damages was a reasonably foreseeable consequence of a breach by BTI or was otherwise contemplated by the parties to the lease. Two Trees incurred attorneys' fees solely because it elected to defend its own indefensible breach of the security agreement related to the letter of credit by permitting its agent to apply all of the proceeds of the letter of credit to a debt not secured by the letter of credit, resulting in an overcharge of the Debtor and a violation of the automatic stay.

Appendix C

Defendants raised two other issues related to the indemnity claim. These issues are (1) whether those alleged damages flowed from the termination of the lease and (2) whether they constituted "rent reserved" under the lease. The failure to prove those damages moots those issues. Nonetheless, the Court will point out flaws in those arguments.

In support of the argument that their alleged indemnity claim did not arise from termination of the lease and hence would not be not subject to cap in section 502(6)6), the Two Trees Defendants rely on *In re Atlantic Container Corp.*, 133 B.R. 980 (Bankr. N.D. Ill. 1991) and *In re Best Products Co., Inc.*, 229 B.R. 673 (Bankr. E.D. Va. 1998). These cases are on point, they say, because those courts allowed claims for breaches of leases that were not rent claims. They argue that limits on rent claims do not apply to the indemnity claim because that claim arises from breach of "independent and separate covenants." Two Trues' Trial Memorandum of Law, p. 9 (document no. 140).

In both *Atlantic Container and Best Products*, the primary issue was whether damages flowing from a prepetition breach of a covenant to repair the premises were subject to the cap under section 502(b)(6). Both courts answered that question in the negative, holding that a prepetition breach of a covenant to repair did not arise from the postpetition termination of the lease. In addition, the *Atlantic Container* court held that the portion of damages suffered by two landlords for post-petition but pre-rejection breaches of the repair covenants were administrative expenses that should be paid in full.

Appendix C

The Two Trees Defendants ignore the critical factual distinction between those cases and this one. In those cases, the breaches of covenants in fact occurred prior to the rejection of the leases and for the most part prior to the petition date. The damages sustained by those landlords in fact occurred at the time of the breaches. In the present case, the breach actually occurred postpetition on November 1 1, 1998, the date on which the lease was deemed rejected. The alleged damages actually occurred after that date.

The Two Trees Defendants also misconstrue the holdings of those cases, Their argument proceeds from the false premise that nonpayment of rent is the only breach that occurs because a lease is terminated. Termination though rejection results in a breach of every promise the tenant makes in the lease. Their argument is also illogical in that it begs the question by assuming the conclusion that breach of the indemnity covenant did not arise from termination.

The breach of any covenant, not just a covenant to pay rent, by a trustee or debtor in possession after rejection results directly from that rejection, which, as pointed out earlier, is a termination of the lease for purposes of section 502(b)(6). Rejection is a breach of the entire lease that is deemed to have occulted immediately prior to the filing of the petition. A trustee fails to perform any and all covenants after rejection because the trustee has no authority or legal duty to perform after rejection! The trustee, as fiduciary of the estate, lacks authority to use property of the estate to make payments on a landlord's rejection claim, which is deemed to be a prepetition claim, or to use estate property outside the ordinary course of business to cure defaults on a lease that

has been rejected and is no longer of any benefit to the estate. 11 U.S.C. § 363. Were it otherwise, section 502(b)(6) would be meaningless. By contrast, the debtors in the *Atlantic Container* and *Best Products* cases had the legal duty to make repairs prior to the petition date, and the estates had the same duty during the bankruptcy cases prior to the respective rejection dates. Hence, the contention that any damages occurring after rejection did not result from termination is without merit.

CITBC characterized the expenses incurred by Two Trees in selling the Camden facility in September 1999 as "rent." The Two Trees Defendants in one of their alternative arguments characterized both the sale expenses and the attorneys' fees incurred in this action as "rent." They made this argument in order to beef up the portion of the claim subject to the section 502(b)(6) cap. Defendants based their positions on the argument that the word "Rent" as defined in the lease includes "Minimum Rent" and the "Additional Charges" set out in section 2.3 of the lease, which includes "all amounts, liabilities, obligations, and Impositions which Lessee assumes or agrees to pay under this Lease."

The term "rent reserved" in section 502(b)(6) means those obligations in a lease that (a) are designated as rent or additional rent, (b) are related to the value of the leased property and (c) are fixed, regular or periodic charges. *In re McSheridan*, 184 B.R. 91, 99-100 (9th Cir. BAP 1995); *In re Smith*, 249 B.R. 328, 337 (Bankr. S.D. Ga. 2000). The requirement that all three of these conditions be met is essential to achieving the purpose of section 502(b)(6). Otherwise, every landlord could easily draft around that

section. The sale and attorneys' fee expenses claimed as damages do not constitute "rent reserved" under the lease because those expenses did not relate to the value of the leased premises and were not fixed, regular or periodic charges.

If the actual damages had exceeded the "rent reserved" under the lease for one year following the petition date, the Court would have had to address Plaintiff's contention that the annual payments due for real estate taxes, insurance and repairs and maintenance do not constitute "rent reserved." The Court need not decide this issue because the Minimum Rent for one year is $453,900.00, which exceeds the amount of damages that Two Trees can claim as a result of termination of the lease.

Plaintiff's argument that the postpetition rent payments it and Schneider made should be deducted from the cap, if it were applicable, is without merit. *In re Atlantic Container, supra* at 989-91; *In re Financial News Network*, 149 B.R. 348 (Bankr. S.D.N.Y. 1993).

In conclusion, the allowable claim of Two Trees against the Debtor for breach of the lease of the Camden facility is and was $424,004.56, which is the sum of the net Minimum Rent claim of $363,641.25 and the claim for payment of real estate taxes, insurance and repair and maintenance costs of $60,363.31. As set forth in this Court's Order dated October 4, 2002 granting Plaintiff's motion for summary judgment, CITBC as agent for Two Trees and for its own account as the secured lender to the Debtor had no legal right to retain the difference between the proceeds of the letter of credit in

the amount of $1,600,000 and the amount of Two Trees' allowable claim for damages for breach of the lease, which difference amounts to $1,175,995.44. CITBC inflated its own secured claim against the estate by $1,175,995.44, which the Debtor paid, at the closing of the sale of assets to Schneider International, Inc. As a result of Defendants' illegal conduct, Plaintiff suffered damages of $1,175,995.44 and is entitled to a judgment against Defendants jointly and severally for that amount, plus interest from the date of the judgment at the rate specified in 28 U.S.C. § 1961. The Court will enter a separate judgment.

IT IS SO ORDERED.

This 15th day of July 2004.

s/ James E. Massey
JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE

APPENDIX D — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA ATLANTA DIVISION

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

CIVIL ACTION

1:02-CV-3052-MHS

TWO TREES, a New York general partnership, et al.,

Appellants,

v.

BUILDERS TRANSPORT, INC.,

Appellee.

ORDER

Appellants Two Trees, a New York general partnership, and its general partners, David C. Walentas and Jane Walentas, appeal from that portion of the Bankruptcy Court's Order dated September 30, 2002, granting the motion of appellee/debtor Builders Transport, Inc. (BTI), for summary judgment as to appellants' liability on BTI's claim for a turnover of excess proceeds from a letter of credit pursuant to 11 U.S.C. § 542(b). For the following reasons, the Court affirms the Bankruptcy Court's Order.

Appendix D

Background

On. May 21, 1998, BTI petitioned for relief under Chapter 11 of the Bankruptcy Code. At the time of the bankruptcy filing, BTI was engaged in the business of interstate trucking and maintained its headquarters in Camden, South Carolina. For several years prior to the bankruptcy, BTI's operations had been financed by The CIT Group/Business Credit, Inc. (CIT), under a combination of revolving credit lines, term loans, and letter of credit facilities pursuant to an Amended and Restated Financing Agreement dated as of May 28, 1998 (Financing Agreement).

In the 1980s, BTI invested in the stock of a satellite messaging company that ultimately proved worthless, generating various write-offs and resulting capital losses. By 1995, BTI still had available to it a capital loss carry-forward of some $1,530,000, which was due to expire at the end of the year. Also in 1995, BTI completed the final payment owed in connection with a local revenue bond offering issued to finance its Camden headquarters. BTI thus effectively owned the property debt-free and saw the opportunity to take advantage of the about-to-expire capital loss carry-forward by entering into a sale leaseback transaction. The sale of the property would generate immediate cash for the company, and the capital gain would be offset by the capital loss carry-forward.

Accordingly, on October 11, 1995, BTI sold its headquarters property for $3.5 million dollars to Two Trees, a real estate company principally owned by David Walentas, who was also Chairman of the Board of BTI. Two Trees then

leased the property back to BTI for a five-year term (the Lease), with BTI having an option to renew the Lease for four successive five-year terms at then current market rent.

Pursuant to a provision in the Lease, BTI obtained a letter of credit in favor of Two Trees from Dal-Ichi Kangyo Bank (DK Bank) in the amount of $1.6 million to secure BTI's obligations under the lease (the Letter of Credit), DK Bank issued the Letter of Credit at the request of CIT pursuant to CIT's agreement to reimburse DK Bank for any amounts it was required to pay under the Letter of Credit. In turn, BTI was obligated to reimburse CIT any such amounts under the Financing Agreement.

Two Trees financed the entire $3.5 million purchase price with a loan from CIT, which was secured by a first mortgage lien on the property and assignments of Two Trees' rights under the Lease and the Letter of Credit. In addition, David Walentas and his wife Jane personally guaranteed the note to CIT.

The base rent due to Two Trees under the Lease was equal to the debt service due to CIT under the mortgage. Thus, the Lease was conceived and structured as a pass-through payment arrangement. BTI paid rent directly to a lock-box controlled by CIT in an amount pegged to the amount necessary to satisfy Two Trees' principal and interest obligations under the note.

After BTI filed for bankruptcy, CIT acting as BTI's lender, accelerated BTI's obligations under the Financing Agreement, causing the Letter of Credit issued in favor of

Two Trees to expire in 30 days. Prior to the expiration, and now acting as Two Trees' lender and assignee, CIT drew down the entire $1.6 million under the Letter of Credit. In turn, once again acting as BTI's lender, CIT reimbursed DK Bank in the amount of $1.6 million and then charged the $1.6 million reimbursement to BTI's line of credit, which was secured by a lien on BTI's assets. Finally, acting again as Two Trees' lender, CIT used the $1.6 million received from DK Bank to pay down the mortgage debt Two Trees owed to CIT. Subsequently, substantially all of BTI's assets were sold to a third-party purchaser, and CIT was paid that portion of the purchase price necessary to satisfy its secured claims against BTI, including the $1.6 million claim for CIT's reimbursement of DK Bank for the proceeds of the Letter of Credit.

The net effect of all this was that BTI funded a pay-down of Two Trees' mortgage debt to CIT in the amount of $1.6 million. BTI contends that this amount greatly exceeded its obligations to Two Trees under the Lease, which was all that the Letter of Credit was intended to secure. Therefore, BTI initiated an adversary proceeding against appellants and CIT seeking to recover the excess amount. On September 30, 2002, the Bankruptcy Court granted BTI summary judgment as to appellants' and CIT's liability on its claim but reversed the issue of damages for trial. This appeal followed.

Appendix D

Discussion

Generally speaking, where a lessee makes a security deposit with a landlord to secure rent and later files for bankruptcy, the landlord must apply the security deposit to its allowed claim under 11 U.S.C. § 502(b)(6) and return the excess to the debtor's estate. *See, e.g., Oldden v. Tonto Realty Corp.,* 143 F.2d 916 (2d Cir. 1944); *In re Danrik, Ltd.,* 92 B.R. 964 (Bankr. N.D. Ga. 1988). BTI contends that the general rule applies to the proceeds of the Letter of Credit in this case, because the Letter of Credit was given to secure BTI's Lease obligations to Two Trees, and the amount of that security exceeded the amount of the obligation secured, thus giving rise to a duty by Two Trees and CIT to return the excess security.

Appellants contend that the general rule does not apply in this case for two reasons. First, appellants argue that under the doctrine of independence the proceeds of the Letter of Credit do not constitute property of the bankruptcy estate subject to turnover. Second, appellants argue that the statutory cap on lessor damages does not apply because the Lease was not a true lease but a disguised financing transaction. The Bankruptcy Court rejected both of appellants' arguments and granted summary judgment to BTI. The Court reviews the Bankruptcy Court's grant of summary judgment *de novo. See In re Hicks,* 241 B.R. 456, 458 (D. Ariz. 1999).

Appellants argue that the under the independence principle neither a letter of credit nor its proceeds constitute property of the bankruptcy estate, because "[w]hen the issuer of a letter of credit honors a proper draft under it, the issuer

does so from its own funds, not from the assets of the customer who caused the letter of credit to be issued." *In re Metro Communications, Inc.*, 115 B.R. 849, 854 (Bankr. W.D. Pa. 1990). BTI responds that the independence principle does not apply, because the issue is not whether CIT property drew down the Letter of Credit, but whether the amount of the proceeds exceeded BTI's liability to Two Trees under the Lease.

The Court concludes that the independence principle does not apply here. "[T]he doctrine of independence protects only the *distribution* of the proceeds of the letter of credit . . . and does not address claims respecting the underlying contract." *In re Graham Square, Inc.*, 126 F.3d 823, 827-28 (6th Cir. 1997) (emphasis in original). "Once the proceeds of a letter of credit have been drawn down, the underlying contracts become pertinent in determining which parties have a right to those proceeds." *Resolution Trust Corp. v. United Trust Fund, Inc.*, 57 F.3d 1025, 1034 (11th Cir. 1995).

Here, the underlying contract is the Lease between Two Trees and BTI. The Lease clearly provides that the Letter of Credit was to secure payment only of the rent and other amounts due under the Lease, not the debt of Two Trees to CIT: "Lessee convenants and agrees that it shall obtain and maintain in effect at all times during the Term, as further assurance of the payment by Lessor of all amount of *Rent and other obligations payable by Lessee hereunder*, a standby letter of credit . . . in an amount available to be drawn at least equal to $1,600,000. . . ." (Lease § 7.3) (emphasis added). Likewise, the Letter of Credit itself provides: "The Credit Amount is intended to support Builders' obligations

to pay *rent and other amounts under the Lease*." (Emphasis added.)

Appellants rely on a Lease provision obligating BTI to reimburse Two Trees for all "additional expenses" incurred as a result of a default, including "all losses incurred by Lessor [Two Trees] as a direct or indirect result of Lessee's [BTI] default (including any appropriate action by the Facility Mortgagee [CIT]. . . ." (Lease § 15.3(c).) Appellants argue that the reference to "indirect" losses "was plainly intended to capture the overall intent that the Letter of Credit stood as security for Two Trees' obligations under the Note." (Appellants' Br. at 15.) However, as the Bankruptcy Court correctly pointed out (Order at 19), the losses referred to in subsection (c) of section 15.3 are *in addition* to the payment of rent required under subsections (a) and (b). Even if Two Trees' obligations to pay the note to CIT is deemed a "loss,"[1] it is the same loss as not receiving the rent from BTI, and thus is not *in addition* to the loss for nonpayment of rent. Therefore, it is not one of the "additional expenses" covered by subsection (c).

Appellants also rely on a provision in the Letter of Credit that permit Two Trees or its assignee to draw down the full credit amount in the event that CIT accelerates BTI's debt under the Financing Agreement and DK Bank gives notice that, as a result, the Letter of Credit will expire in 30 days. Appellant argues that this shows the Letter of Credit was not tied exclusively to Lease defaults. This provision, however,

1. As the Bankruptcy Court also correctly noted, Two Trees suffered no loss by having to pay back the loan from CIT, because it received the proceeds of the loan.

does not show that the Letter of Credit was intended to secure anything other than BTI's Lease obligations. As the Bankruptcy Court correctly pointed out (Order at 23), it would be "utterly preposterous" to argue that if Two Trees had drawn down the full amount of the Letter of Credit under this provision, and BTI had subsequently performed all of its obligations under the Lease, that Two Trees could have still retained the proceeds of the Letter of Credit as a windfall.

Appellants also argue that the statutory limit on a landlord's recovery of damages set out in 11 U.S.C. § 502(b)(6) does not apply to the proceeds of a letter of credit.[2] However, the cases cited by appellants do not support this proposition. In *In re Farm Fresh Supermarkets of Md., Inc.*, 257 B.R. 770 (Bankr. D. Md. 2001), the trustee sought turnover of the proceeds of a letter of credit drawn down by the debtor's landlord. The bankruptcy court dismissed the complaint because the trustee had previously assumed and assigned the lease on behalf of the estate, "and with that assumption and assignment went all the rights and obligations that came with the lease." *Id.* at 772. The *Farm Fresh* court

2. This argument is relevant only if appellants can prove damages in excess of the statutory cap, which, in this case, is 12 months' rent. BTI contends that Two Trees' maximum claim is for only 9 months' rent, the period between the date through which rent was last paid and the date the property was sold. Appellants, on the other hand, contend that Two Trees' actual damages exceed the $1.6 million proceeds of the Letter of Credit. Presumably, however, appellants' calculation is based on the contention that their damages include the total amount necessary to pay off Two Trees' note to CIT, a contention that has been rejected by both the Bankruptcy Court and this Court.

did not discuss the applicability of section 502(b)(6). Appellants also cite an unpublished decision denying a motion for partial summary judgment pursuant to 11 U.S.C. § 502(b)(6), but the bankruptcy court's perfunctory order in that case contains no discussion whatsoever of the basis for its decision. *In re Darwin Networks, Inc.*, Case No. 01-0095 (JCA) (Bankr. D. Del. Aug. 24, 2001).

Finally, appellants argue that the Lease was not a true lease, but a disguised financing transaction, and that section 502(b)(6) is therefore inapplicable.[3] The Bankruptcy Court correctly held that the Lease was a true lease. "[T]he most significant factor in determining whether a transaction is a lease or a sale is whether the lessor has retained a residual interest at the end of the lease term." *Westship, Inc. v. Trident Shipworks, Inc.*, 247 B.R. 856, 863 (M.D. Fla. 2000). Here, at the end of the five-year lease term, Two Trees retained ownership of the property, and BTI had no right to acquire the property.

Also significant, while BTI's monthly rental payments were equal to Two Trees' monthly mortgage payments, the total amount of the rental payments during the five-year term of the Lease was sufficient to amortize less than half of Two Trees' mortgage debt to CIT. BTI had no obligation to renew the Lease and continue making rental payments with which Two Trees could service its mortgage debt to CIT, and even if BTI did renew the Lease, rental payments during the renewal period would be at fair market rental value rather

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3. Once again, this argument is relevant only if appellants can prove damages in excess of the statutory cap. *See* note 2 *supra.*

than the amount needed to amortize Two Trees' note to CIT. All these facts are inconsistent with appellants' contention that the Lease was intended as a financing arrangement.

Appellants focus on the fact that BTI was motivated to enter into the transaction in order to take advantage of its expiring capital loss carry-forward. However, while this was certainly a consideration, the evidence is undisputed that BTI was also motivated by the cash flow impact of the transaction. The availability of the capital loss carry forward simply meant that BTI could avoid the negative tax consequences of converting its headquarters property into cash. The mere fact that tax avoidance was part of the motivation behind the transaction is not enough, standing alone, to support a conclusion that this was not a true lease.

Nor does the fact that BTI assumed many of the obligations of ownership, such as payment of taxes, insurance, utilities, and maintenance and repair expenses, require a finding that this was not a true lease. As the Bankruptcy Court noted, the lessee's retention of many of the indicia of ownership "its common in triple net leases and does not necessarily indicate the absence of a lease." (Order at 25 (quoting *Westship, Inc.*, 247 B.R. at 863)).

Appendix D

Summary

For the foregoing reasons, the Court AFFIRMS that portion of the Bankruptcy Court's Order dated September 30, 2002, granting the motion of appellee/debtor Builders Transport, Inc., for summary judgment as to appellants' liability on BTI's claim for a turnover of excess proceeds from the Letter of Credit pursuant to 11 U.S.C. § 542(b).

IT IS SO ORDERED, this 7th day of July, 2003.

s/ Marvin H. Shoob
Marvin H. Shoob, Senior Judge
United States District Court
Northern District of Georgia

APPENDIX E — ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF GEORGIA, ATLANTA DIVISION DATED SEPTEMBER 30, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

JOINTLY ADMINISTERED
UNDER CASE NO. 98-68798

CHAPTER 11

JUDGE MASSEY

ADVERSARY NO. 99-6480

IN RE:

BUILDERS TRANSPORT, INC., et al.,

Debtors.

BUILDERS TRANSPORT, INC.,

Plaintiff,

v.

TWO TREES, a New York general partnership, DAVID C. WALENTAS, JANE WALENTAS and THE CIT GROUP/ BUSINESS CREDIT, INC., a New York corporation,

Defendants.

Appendix E

ORDER GRANTING IN PART AND DENYING IN PART MOTION FOR PARTIAL SUMMARY JUDGMENT FILED BY PLAINTIFF; DENYING MOTION FOR SUMMARY JUDGMENT AGAINST PLAINTIFF AND IN THE ALTERNATIVE AGAINST CO-DEFENDANTS FILED BY DEFENDANT THE CIT GROUP/BUSINESS CREDIT, INC.; DISMISSING CROSS-CLAIM OF THE CIT GROUP/BUSINESS CREDIT, INC.; AND DENYING MOTION FOR SUMMARY JUDGMENT FILED BY DEFENDANTS TWO TREES, DAVID C. WALENTAS AND JANE WALENTAS

Builders Transport, Inc. ("BTI or Debtor") brings this adversary proceeding against The CIT Group/Business Credit, Inc. ("CITBC"), Two Trees, a New York general partnership, and David C. Walentas and Jane Walentas, to recover property or damages arising from complicated financial dealings among the parties. BTI is the lead Chapter 11 debtor in these jointly administered Chapter 11 cases. CITBC was BTI's primary lender before and during the Chapter 11 case, which BTI filed in 1998. Two Trees purchased in 1995 and leased back to BTI real property in Camden, South Carolina on which BTI conducted its interstate trucking business. David and Jane Walentas are general partners of Two Trees, and Mr. Walentas was BTI's Chairman at the time the sale and leaseback transaction closed.

The complaint contains five counts. In Count One, BTI seeks to recover from Defendants the amount by which the proceeds of a letter of credit securing certain obligations of BTI to Two Trees under the lease agreement for the Camden

property exceeded the amount of those obligations. As assignee of Two Trees, CITBC drew down the letter of credit after the petition date and then applied the proceeds to pay down a debt of Two Trees to CITBC. The issuer of the letter of credit was secured by a reimbursement guaranty given by CITBC, and BTI had agreed to reimburse CITBC for what it paid to the issuer of the letter of credit. In Counts Two, Three and Five, BTI seeks from CITBC the turnover of cash collateral and interest on cash collateral held by CITBC. In Count Four, BTI contends that CITBC improperly charged expenses to BTI, for which BTI is due a refund.

Defendants filed answers denying that Plaintiff is entitled to the relief sought in the complaint. CITBC filed a cross-claim against Two Trees and the Walentases in the event that it is liable to Plaintiff on Count One. All of the parties move for summary judgment on Count One. CITBC moves in the alternative for summary judgment against Two Trees and the Walentases if it loses on Count One. CITBC also moves for summary judgment on Counts Two, Four and Five.

This Court has jurisdiction to decide these disputes, except for the cross-claim, pursuant to 28 U.S.C. §§1334(b) and 157(a) and the Order of reference of the United States District Court for the Northern District of Georgia entered on July 12, 1984 and Local Rule 83.7(A) of that Court. Each of the disputes in this adversary proceeding, except for the cross-claim, constitutes a core proceeding within the meaning of 28 U.S.C. §157(b)(2)(A), (B), (E), (K) and (0). To the extent that the Court is mistaken about its core jurisdiction, this order and the judgment or judgments entered in this adversary proceeding should be construed as recommendations to the United States District Court for the Northern District of Georgia.

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The Court will first address the facts relevant to Count One and then analyze the legal issues presented. Thereafter, the Court will deal with CITBC's motion on the other Counts.

Builders Transport, Inc. and related companies were in the trucking business. Its headquarters facility located in Camden, Kershaw County, South Carolina had been constructed with the proceeds of industrial revenue bonds, and BTI leased the facility from Kershaw County until 1995. In that year, the bonds were paid, and BTI was entitled to purchase the property for $1.

BTI's primary lender was CITBC. It and CITBC entered into an Amended and Restated Financing Agreement in 1993, which was thereafter amended from time to time, pursuant to which CITBC provided to BTI a revolving line of credit, term loan, and letter of credit facilities, secured by virtually all of BTI's assets.

In 1990, the Debtors had written off worthless stock of a satellite messaging company, producing a capital loss carryforward that would expire on December 31, 1995. For several months prior to October 1995, BTI had explored selling and leasing back the Camden property.

In the fall of 1995, $1,530,000 of the capital loss carryforward remained unused and could not be used unless BTI had sufficient income in that fiscal year to offset the loss. Stanford M. Dinstein was an officer and director of Builders Transport Incorporated, a public company and sole shareholder of BTI, and was apparently the architect of the sale and leaseback plan involving Two Trees. The purpose

of the sale and leaseback transaction was to provide liquidity to the company, Transcript, Deposition of Jerrold K. Brown, January 5, 2000, pp. 34-5, and part of that liquidity came from being able to use the loss carryforward.

In considering Mr. Dinstein's idea, officers of BTI and its parent consulted their outside accountants, Ernst & Young, who advised them concerning the structure of the deal and what facts would support the legitimacy of the sale and hence the ability to legally use the loss carryforward. For tax reasons, Ernst and Young advised against having BTI guarantee the obligations of Two Trees to CITBC.

On October 5, 1995, the Board of Directors of Builders Transport Incorporated met to consider the sale and leaseback deal with Two Trees. At that time, Defendant David Walentas was a general partner in Two Trees and the Chairman of the Board of BTI's parent, as well as Chairman of the Board of BTI. Mr. Walentas did not attend the October 5, 1995 Board meeting, however. Nor did he act on behalf of Two Trees, as one its general partners, in connection with these transactions. Instead, Mr. Dinstein chaired that Board meeting. And he represented Two Trees as its attorney in fact in the sale and leaseback transactions. The Board, with Mr. Dinstein abstaining, unanimously approved resolutions authorizing the sale and leaseback transaction.

The following day, Builders Transport Incorporated, as the sole shareholder of BTI, by Robert Gamer, its corporate secretary, executed a written consent in lieu of a shareholder meeting adopting resolutions on behalf of BTI approving the transactions and authorizing officers to execute and deliver

the appropriate documents. That consent, attached as an exhibit to Mr. Gamer's affidavit filed on June 26, 2000, in support of Plaintiff's motion, states in part: "FURTHER RESOLVED, that it is in the best interest of the [BTI] to obtain a letter of credit in the amount of up to $1.6 million in favor of Two Trees (the "Letter of Credit") securing [BTI's] lease obligations to Two Trees."

The deal closed on or about October 11, 1995. Two Trees purchased the Camden property from BTI for $3.5 million and leased the property back to BTI. The lease agreement provided for a five-year term, commencing on October 12, 1995, with BTI having the option to renew the lease for four successive periods of five years each at then fair market rent. The lease agreement provided that BTI would obtain a letter of credit to secure its obligations under the lease. On or about October 12, 1995, Dai-Ichi Kangyo Bank ("DK Bank") issued a letter of credit in favor of Two Trees "in its capacity as 'Lessor'," on behalf of BTI, in the amount of $1.6 million to "support Builders' obligation to pay rent and other amounts under the Lease."

On June 21, 1995, CITBC and DK Bank had executed a reimbursement agreement, wherein CITBC was obligated to reimburse DK Bank for any payments made by DK Bank on letters of credit that DK Bank issued at the request of CITBC. In the event that CITBC was obligated to reimburse DK Bank for monies paid under a letter of credit issued for BTI's benefit, the financing agreement between BTI and CITBC obligated BTI to reimburse CITBC for the same amount.

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Two Trees borrowed from CITBC the $3.5 million it paid to BTI for the Camden property. In agreements executed by Mr. Dinstein, Two Trees secured its obligation to CITBC with a mortgage on the Camden property and with an assignment of its interest in the lease agreement with BTI and in the letter of credit issued by DK Bank. The rent paid by BTI went directly to CITBC pursuant to a lockbox agreement between CITBC and Two Trees. The amount of BTI's monthly lease payment was $37,825, which was the amount of the note payment due from Two Trees to CITBC. Had the note of Two Trees to CITBC been amortized according to its terms, Two Trees would still have owed CITBC in excess of $2,000,000 at the end of the 60-month lease term. The assignment of the letter of credit was acknowledged in a letter dated November 8, 1995 from Two Trees to DK Bank.

On May 21, 1998, Builders Transport, Inc., Builders Transport, Incorporated, CCG Corp., Inc., Builders Transport of Texas, Inc., Alstaff, Inc., Applied Logistic Systems, Inc., and Grand Prairie Land Company filed in this Court voluntary petitions pursuant to chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101, *et seq.* Subsequent to the petition date, the Debtors continued for a few weeks to operate the business as debtors-in-possession. Under section 1107 of the Bankruptcy Code, a debtor in possession possesses most, though not all, of the powers of a trustee.

Virtually all of the Debtors' assets secured prepetition debt to CITBC, as agent for itself and another company, and to The CIT Group/Equipment Financing, Inc. With court approval, the Debtors and the CIT companies stipulated to the use of cash collateral by the Debtors and to the grant of a

postpetition security interest in the Debtors' assets to secure the claims of the CIT companies. The Court approved that agreement in an order entered on May 22, 1998 (the "Cash Collateral Order").

The Cash Collateral Order was modified in an order entered on June 18, 1998, to delete paragraph 8(0) and to substitute a new paragraph 8(0), which provides in relevant part as follows:

> 8(0) ... This Order does not constitute a waiver of or prejudice the right of the Committee or the Debtor to (x) contest the validity, priority, or perfection of the security interests and liens of the Agent or CITEF in the Pre-petition Collateral pursuant to the CITBC Agreements or the CITEF Agreements (but not in the Replacement Collateral pursuant hereto, except to the extent of any invalidity or lack of perfection of the security interests and liens of the Agent or CITEF in the Pre-petition Collateral), or (y) to commence and prosecute any claims, actions or causes of action against the Agent, the Lenders, or CITEF.

It quickly became obvious to everyone involved in this case that the Debtors' efforts at reorganization as a going concern could not be successful. BTI conducted a public auction of certain parts of its business on June 29, 1998, and the Court approved the sale of those assets to Schneider National, Inc. in an order entered on July 10, 1998. The asset purchase agreement between BTI and Schneider permitted Schneider to occupy the Camden property on a shared use

basis with BTI for four months with Schneider to pay 75% of the rent to Two Trees. With respect to the claims of CITBC, the July 10, 1998 Order provided in relevant part:

> 10. The Debtor is hereby authorized and directed to pay the indebtedness due to CITBC and CITEF allegedly secured by their blanket security interest and first priority lien on the Debtor's Pre-petition Collateral from the proceeds of the sale of the Purchased Assets at Closing. To the extent that letters of credit guaranteed by CITBC have not yet been surrendered, CITBC is authorized to hold as cash collateral proceeds of the sale of Purchased Assets to cover the obligations which may arise if those letters of credit are called. All of this is without prejudice to any claim of the Debtor, any subsequently appointed Trustee and/or the Committee challenging the validity, priority, extent, perfection or amount of such claims asserted by CITBC and CITEF.

On July 9, 1998, CITBC, wearing its hat as BTI's lender, sent a notice to DK Bank that BTI's obligations under the financing agreement had been accelerated. On July 15, 1998, DK Bank notified CITBC, wearing its hat as the lender to and assignee of Two Trees, that because CITBC had accelerated the debt of BTI, the letter of credit would expire in 30 days. On July 15, 1998, CITBC, wearing its hat as lender to and assignee of Two Trees, submitted to DK Bank a completed "Default Draft" for $1.6 million.

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On or about July 22, 1998, DK Bank paid $1.6 million to CITBC, wearing its lender to Two Trees hat, and CITBC, wearing its hat as BTI's lender, reimbursed DK Bank in the amount of $1.6 million

On or about July 22, 1998, CITBC, wearing its hat as BTI's lender, charged the amount of $1.6 million to BTI's line of credit, which was secured by property of the estate. Also on July 22, 1998, CITBC, wearing its hat as lender to Two Trees, used the $1.6 million received from DK Bank to pay down the debt Two Trees owed to CITBC.

The sale of assets to Schneider closed on August 3, 1998. At the closing, Schneider, BTI and CITBC executed a termination agreement and a closing statement, which set forth the amount of CITBC's secured claim, which included the $1.6 million charge to BTI's line of credit for the reimbursement of DK Bank. CITBC received payment of its claim from the purchase price paid by Schneider. CITBC released its lien on the Debtor's assets, with the exception of certain accounts created pursuant to the termination agreement, and the financing agreement between CITBC and BTI was terminated.

In October or November 1998, Schneider vacated the Camden property; the Debtors had previously moved out. Plaintiff alleges in the complaint that it made rent payments through at least August 31, 1998, and that Schneider made at least three months of payments totaling $129,975. Defendants deny knowledge of, or dispute, these allegations.

In December 1998, Stanford Dinstein died.

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Two Trees sold the Camden property to a third party, PrimeRealty Group, LLC, on or about September 8, 1999.

As mentioned, all the parties move for summary judgment on Count One. Pursuant to Fed. R. Civ. P. 56(c) incorporated in Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The moving party bears the initial burden of proof to establish that no genuine factual issue exists. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *Clark v. Coats & Clark, Inc.*, 929 F.2d 604, 608 (11th Cir. 1991). The movant must point to the pleadings, discovery responses or supporting affidavits which tend to show the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323. The court must construe this evidence in the light most favorable to the non-moving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986); *Rollins v. TechSouth, Inc.*, 833 F.2d 1525, 1528 (11th Cir. 1987).

Unless the moving party satisfies its burden to show an absence of a genuine issue of material fact, no burden of going forward arises for the opposing party to demonstrate that a genuine issue of material fact exists. *Clark*, 929 F.2d at 608. Where the moving party satisfies its burden, the burden of going forward shifts to the non-moving party to demonstrate that a genuine issue of material fact indeed exists. The non-moving party must designate "specific facts showing that there is a genuine issue for trial" *Celotex*, 477 U.S. at 324.

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Count One of the complaint is titled "COMPLAINT FOR TURNOVER OF EXCESS SECURITY." The essence of Count One is that the letter of credit was given to secure a debt owed by BTI to Two Trees and that the amount of that security exceeded the amount of the debt secured, giving rise to a duty by Two Trees and CITBC to return the excess security. In the demand portion of that Count, Plaintiff refers to sections 542 and 543 of the Bankruptcy Code. Section 543 deals with the turnover of property of the estate by a custodian. Because neither CITBC nor Two Trees was a custodian within the meaning of that section, it plainly does not apply. Section 542 provides in relevant part:

> (a) . . . an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.
>
> (b) . . . an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

Property that a trustee may use under section 363 is "property of the estate," which section 541 of the Bankruptcy Code addresses.

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In the classic situation in which a lessee makes a security deposit with a landlord to secure rent and later filed bankruptcy, it is well accepted that the landlord must apply the security deposit to its allowed claim under section 502(b)(6) (as opposed to its total claim), and that any excess security for rent must be returned to the debtor's estate. *See, e.g., Oldden v. Tonto Realty Corp.*, 143 F.2d 916 (2d Cir. 1944); *In re Danrik, Ltd.*, 92 B.R. 964 (Battler. N.D. Ga. 1988); *see also* S.R. No. 989, 95th Cong., 2nd Sess. 63 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5849. Plaintiff contends this rule applies to the proceeds of the letter of credit received by CITBC.

The Defendants respond with several distinct defenses. First, they contend that neither the letter of credit nor the proceeds of the letter of credit are property of the estate and that the "independence principle" applicable to letters of credit insulate them from Plaintiff's claim. Second, they assert that the letter of credit secured Two Trees' debt to CITBC either directly or through a liquidated damages provision inserted in the lease agreement to cover the difference between the price paid by Two Trees and the actual value of the Camden property. Third, CITBC contends that the lease agreement is really a disguised financing arrangement, so that section 502(b)(6) dealing with limitations on lease obligations has no applicability. Fourth, CITBC contends that Plaintiff's claim against CITBC is barred by the terms of the termination agreement and the "voluntary payment doctrine." Finally, CITBC contends that Plaintiff lacks standing to bring Count One because the termination agreement reserves to the creditor's committee, not the Debtor, to challenge CITBC's claim. None of these defenses to liability has any merit.

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In attacking Plaintiff's position, Defendants say that the proceeds of the letter of credit are not property of the estate and that the doctrine of independence bars interference with the distribution of the proceeds to the beneficiary.

The nature of a standby letter of credit was discussed in the Eleventh Circuit case *Resolution Trust Corporation v. United Trust Fund, Inc.*, 57 F.3d 1025 (11th Cir. 1995).

> A standby letter of credit transaction is a three-party agreement involving two contracts and the standby letter of credit. *Dibrell Bros. Int'l S.A. v. Banca Nazionale Del Lovoro*, 38 F.3d 1571, 1578 (11th Cir. 1994). The first party is the account party or customer. Here the account party was Old Pioneer. The second party is the issuing institution, usually a bank. Here that party was FHLB. The contract between the issuing party and the account party is one of the contracts involved in a letter of credit transaction. Here Old Pioneer pledged $9 million worth of performing mortgages as collateral for the letter of credit. In the event the letter of credit was drawn upon, the FHLB would be entitled to ask Old Pioneer to reimburse it. If the FHLB was then reimbursed, it would return to Old Pioneer the collateral pledged. Otherwise, the FHLB would have had the right to recover from the pledged collateral.
>
> The third party to a letter of credit transaction is the beneficiary of the letter of credit. The contract between the account party and the

> beneficiary is one of the contracts involved in a letter of credit agreement. The letter of credit itself, an obligation between the issuer and the beneficiary, is the final prong of a letter of credit transaction. *Id.*

R.T.C. v. United Trust Fund, Inc., 57 F.3d at 1030.

The Sixth Circuit in *Demczyk v. Mutual Life Insurance Company of New York (In re Graham Square, Inc.)*, 126 F.3d 823 (5th Cir. 1997) dealt with the relationship between a standby letter of credit and an underlying contractual obligation in the context of a bankruptcy case. There, the debtor had provided a refundable commitment fee in the form of a standby letter of credit pursuant to a loan application to Mutual Life. The loan never closed, and the lender presented a proper draft to the issuing bank for payment on the letter of credit to collect the commitment fee. The issuing bank paid the draft. The debtor later filed for bankruptcy, and the trustee filed an adversary action to recover the commitment fee. The bankruptcy court found that although the commitment fee was an illegal penalty under Ohio law, the independence doctrine barred the trustee from recovering the proceeds of the letter of credit and that the fee was paid with the issuing bank's money rather than the debtor's. The district court affirmed, adding that the collateral given by the debtor to finance the letter of credit was worthless and therefore there was nothing to restore to the estate. The Sixth Circuit reversed.

The Court of Appeals held that "the doctrine of independence protects only the distribution of the proceeds

of the letter of credit. It prohibits an attack on the issuing bank's distribution to the beneficiary and does not address claims respecting the underlying contract." *Graham Square*, 126 at 827-828 (emphasis in original). "It is one thing to attempt to prevent the distribution of the proceeds of a letter of credit, an attempt the doctrine of independence is designed to prevent; but it is quite another to bring an action on the underlying contract that created the letter of credit." *Id.*

Rejecting the position of the issuer and the holding of the district court that the letter of credit was not supported by adequate consideration, the Sixth Circuit opined:

> Finally, the debtor's cause of action is based upon the underlying contract and not on the letter of credit. The characterization or status of the $332,000 had passed from "proceeds of the letter of credit" to "commitment fee under the contract."
>
> We have previously held that property of the estate includes the debtor's interest in a cause of action. *Cottrell v. Schilling (In re Cottrell)*, 876 F.2d 540, 542 (6th Cir. 1989). Further, under 11 U.S.C. § 541(a), equitable title unquestionably constitutes property of the estate. The scope of section 541(a)(1) is broad, includes tangible and intangible property, and allows the bankruptcy "trustee to regain possession of property in which the debtor had equitable as well as legal title." *Whiting Pools*, 462 U.S. at 204 n.8, 205, 103 S.Ct. at 2313 n 8, 2314.

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> We find that the district court erred in holding that there was no property of the estate for the trustee to recover.

Graham Square, 126 at 831.

Plaintiff contends that under the holding of *Graham Square*, the excess security provided to Two Trees is property of the estate. Whether the Sixth Circuit intended to go so far as to declare that the proceeds of the letter of credit, which the Court said became the commitment fee in the hands of the beneficiary, were estate property is not clear from the final paragraphs of its decision. The Court did plainly hold that the cause of action under the underlying contract between the debtor and the lender/beneficiary was property of the estate. This principle applies here as well, as will be discussed below.

If the contention of Plaintiff that proceeds of a letter of credit obtained by a debtor are always estate property overstates the law in this area, the contention of Defendants that proceeds of such a letter of credit are never estate property is equally an overstatement. "Fraud provides a well-established exception to the rule that banks must pay a beneficiary under a letter of credit when documents conforming on their face to the terms of the letter of credit are presented." *Semetex Corp. v. UBAF Arab American Bank*, 853 F.Supp. 759 (S.D.N.Y. 1994). The Court of Appeals for the Second Circuit explained the fraud exception in this way: "We think that the essence of the fraud exception is that 'the principle of the independence of [a] bank's obligation under the letter of credit should not be extended to protect' a party

that behaves so as to prevent performance of the underlying obligation, *Sztejn*, 177 Misc. at 722, 31 N.Y.S.2d at 634; the 'fraud' inheres in first causing the default and then attempting to reap the benefit of the guarantee." *Rockwell Intern. Systems, Inc. v. Citibank, N.A.*, 719 F.2d 583, 589 (2nd Cir. 1983). These cases deal with interfering with disbursement under a letter of credit, but the same principles would support the proposition that when a beneficiary or its designee receive the proceeds but commit fraud in their disposition against a debtor in bankruptcy whose assets supported the letter of credit, the letter of credit arrangement may be ignored.

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated." Stapleton v. Holt, 207 Okla. 443, 250 P.2d 451, 453-54 (Okla.1952).

McClellan v. Cantrell, 217 F.3d 890 (7th Cir. 2000).

Whether CITBC committed fraud is an issue raised in Count One to the extent that Plaintiff contends the proceeds of the letter of credit in the hands of CITBC constituted

property of the estate. It is troubling that CITBC applied the funds it received to a debt other than the one owed by the Debtor. It could not have known how much, if anything, the Debtor would owe to Two Trees under the lease. Under the analysis of the Sixth Circuit in *Graham Square*, the proceeds in the hands of the beneficiary lose their character as proceeds of a letter of credit and become the collateral for the debt that the letter of credit was issued to secure. In effect, Plaintiff is contending that CITBC knowingly acted to "prevent performance of the underlying obligation" by misapplying the lease collateral for its own benefit, if so, one might conclude that its purpose was to cheat the Debtor.

CITBC had its thumb in every pie of consequence in this case, and that reality distinguishes this case from the run of the mill letter of credit case. CITBC was the Debtor's prepetition lender and the Debtor's post-petition lender. It was the lender to the Debtor's lessor, Two Trees. It was the guarantor of the Debtor's obligation to reimburse the issuer of the letter of credit. The only contracts involved in this dispute to which CITBC was not a party were the lease agreement and the letter of credit, and as to those agreements, it took an assignment and then called the shots concerning the disposition of the proceeds of the letter of credit. The weight of the many hats CITBC wore combined with fraud in the disposition of the collateral for BTI's debt under the lease would justify collapsing the transactions and disregarding the letter of credit altogether. In that case, CITBC was the landlord and held the collateral constituting proceeds of estate property, the classic landlord/tenant arrangement for securing rent obligations. At least one factual issue remains under this portion of Count One — scienter

— the state of mind of CITBC's agents in directing the collateral for lease obligations to its own benefit

Plaintiff's claim also fits section 542(b): recovery on "a debt that is property of the estate," a debt that arises from the underlying lease agreement, modified by a quasi-contract and the principle of unjust enrichment. Analysis of this aspect of Count One focuses on what debt the letter of credit secured and what the lease agreement provided, if anything, if the value of the collateral exceeded the debt secured.

What did the letter of credit secure? The lease agreement provides in section 7.3 that the letter of credit secured the rent and other amounts due under the lease. That section reads as follows:

> 7.3 **Support for Payment Obligations.** Lessee covenants and agrees that it shall obtain and maintain in effect at all tines during the Term, ***as further assurance of the payment by Lessee of all amount of Rent and other obligations payable by Lessee hereunder***, a standby letter of credit, issued for the account of Lessee or a wholly owned subsidiary of Lessee, for the benefit of Lessor, in an amount available to be drawn at least equal to $1,600,000 or such lesser amount as Lessor or the Facility Mortgagee (as hereunder defined) may specify, which letter of credit shall, among other things, be assignable for security to the Facility Mortgagee and otherwise be substantially in the form of the standby letter of credit issued by Dai-Ichi Kangyo Bank, Ltd., on

> or about the Closing Date, in satisfaction of Lessee's obligations pursuant to this Section 7.3.

(Emphasis added.)

The lease refers in section 7.3 to the terms of the letter of credit. The letter of credit echoes the obligations that it was to secure in its second paragraph, which reads:

> This Letter of Credit is being issued to you in your capacity as "Lessor" under the Lease Agreement dated as of October 10, 1991 (as amended and in effect from time to time, the "Lease") between you and Builders as "Lessee". ***The Credit Amount is intended to support Builders' obligation to pay rent and other amounts under the Lease.***

(Emphasis added.)

Section 15.2 provides for enumerated remedies available to Two Trees if a default occurs, in addition to those provided by law. Under subsection (a) of Section 15.2, the Lessor may take possession of the property if the Lessee abandons it. In that event, it must use its reasonable efforts to relet the premises, but its efforts in that regard do not terminate the lease or the obligation of the Lessee to pay rent. Under subsection (b), the Lessor can terminate the lease and seek and take possession. Under sections 15.2(a) and (b), the Lessor is entitled to monthly rent. Section 15.2(c) provides:

> (c) Lessor may make demand for payment under and apply or retain, as the case may be, the

> amount then available to be drawn under the standby letter of credit, as its remedy for any damages sustained by Lessor, arising out of the termination of the Lease.

Subsection (d) provides that the rights and remedies of the Lessee are cumulative. Section 15. 3 of the lease provides:

> 15.3 **Additional Expenses**. In addition to payments required pursuant to subsections (a) and (b) of Section 15.2 above, Lessee shall compensate Lessor for all reasonable expenses incurred by Lessor in repossessing the Leased Property (including any increase in insurance premiums caused by the vacancy of the Leased Property), all reasonable expenses incurred by Lessor in reflecting (including repairs, remodeling, replacements, advertisements and brokerage fees), all reasonable concessions granted to a new tenant upon reflecting (including renewal options), all losses incurred by Lessor as a direct or indirect result of Lessee's default (including any appropriate action by a Facility Mortgagee), and a reasonable allowance for Lessor's administrative efforts, salaries and overhead attributable directly or indirectly to Lessee's default and Lessor's pursuing the rights and remedies provided herein and under applicable law.

CITBC argues that the letter of credit was intended to secure the debt of Two Trees to CITBC by securing any loss

that Two Trees might sustain if BTI did not make lease payments. It further contends that the lease agreement contains a liquidated damages provision designed to accomplish that purpose. These arguments are grounded on CITBC's view that the sale price paid by Two Trees for the Camden property was inflated and that the purpose of the letter of credit was to cover the difference between the value of the property and what Two Trees owed CITBC.

CITBC has not identified any provision in the lease agreement or in any other document that even remotely suggests that the letter of credit secured the debt of Two Trees to CITBC, and the Court has found no such provision. CITBC filed the affidavit of Jerrold K. Brown, an officer of CITBC, on June 26, 2000, to support its argument that the real purpose of the letter of credit was to reimburse Two Trees and CITBC in the event of a default because the value of the Camden property was much less than its actual value. Mr. Brown stated that at the time the sale and lease-back and related transactions were being negotiated, CITBC did not believe that the Camden property was worth what Two Trees was paying for it and asked for additional collateral. Mr. Brown then states, "CITBC agreed to accept a letter of credit for approximately $1,600,000 as collateral for the [Two Trees] Note. The $1,600,000 figure was calculated as the expected shortfall between the value of the Camden Property and the amount of the debt owed by Two Trees on the Note." Affidavit of Jerrold Bro led on June 26, 2000, p. 3.

Mr. Brown's statement as to what CITBC "agreed to accept" is both a conclusion of law and hearsay as to what the parties intended (assuming, *arguendo*, that the lease is

ambiguous), because neither he nor CITBC was a party in the first instance to the lease agreement or the letter of credit. The second sentence quoted above is in the passive voice and does not identify who made the calculation described and hence proves nothing. Obviously if it was a calculation he made based solely on his interpretation of what the agreement between BTI and Two Trees was, his testimony about his own thoughts would not be admissible to construe the lease agreement to which neither he nor his employer was a party. CITBC offered no other evidence to support Mr. Brown's speculative interpretation.

CITBC contends that the words "all losses incurred by Lessor as a direct or indirect result of Lessee's default (including any appropriate action by a Facility Mortgagee)" in section 15.3(c) of the lease agreement evidences the parties' intention that the letter of credit secure the obligation of Two Trees to CITBC. As stated in CITBC's final brief, "[t]hat obligation to pay Two Trees' losses naturally included the obligation to pay the Note [of Two Trees to CITBC]." Reply Brief of CITBC, filed July 27, 2000, p. 9. That argument is logically flawed because it assumes the result that it reaches.

The argument also flounders on the unambiguous opening text of section 15.3(c) that the remedies in that subsection are "[i]n addition to payments required pursuant to subsections (a) and (b) of Section 15.2 above." The losses referred to in subsection (c) are *in addition* to payments required in subsections (a) and (b), which required the payment of rent. Hence, even assuming that having to pay the note to CITBC was a "loss," that "loss" and the loss of

not receiving the rent are the same loss, so that the "loss" of having to pay the note is not *in addition* to the loss incurred for non-payment of rent. Moreover, Two Trees suffered no "loss" by having to pay back a loan because it received the proceeds of the loan. Imagine that Two Trees had paid the note in full prior to July 1998. In that event, its only claim constituting a loss would have been non-payment of rent. Thus, the argument of CITBC implies that Two Trees could create a "loss" or not, depending on when it paid the note and out of what assets. This observation guts the argument that its having to pay the note was a loss in addition to the loss it may have suffered in not receiving rent. An example of the type of loss this clause would cover is one occasioned by Two Trees having to refinance the debt at a higher interest rate if it could not pay CITBC as a result of BTI's failure to pay rent. There is no evidence that this clause was intended by BTI and Two Trees to protect Two Trees or CITBC in the event of a default because the value of the property was less than what Two Trees paid for it or otherwise to guarantee the debt of Two Trees to CITBC.

Mr. Walentas testified at his deposition taken on January 12, 2000 and offered by Plaintiff in support of its motion as follows:

> Q. Are you aware, in your own knowledge, of any provision of the lease agreement that we've marked Plaintiff's Exhibit 20 in which Builders Transport, Inc. promises to pay any debt of Two Trees to The CIT Group/Business Credit?
>
> A. I'm Not.

Transcript, David Walentas as Deposition, January 12, 2000, p. 40.

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The minutes of the meeting of the Board of Directors of Builders Transport, Incorporated, on October 5, 1995, and the unanimous consent of Builders Transport Incorporated to resolutions authorizing BTI to enter into the various agreements related to the sale and leaseback transaction contain no suggestion, direct or indirect, that the letter of credit was for the purpose of securing the obligation of Two Trees to CITBC so as to protect either of those entities from loss due to the difference between the sale price and the actual value of the property. To the contrary, they show that the directors and officers authorizing the transactions intended the letter of credit to secure those obligations of BTI specified in the lease agreement.

The argument concerning liquidated damages is based on section 15.2(c) of the lease agreement, which by its terms applies only to a "remedy for any damages sustained by Lessor, arising out of the termination of the Lease." When CITBC drew on the letter of credit in July 1998, the lease had not been terminated. The provision in the lease that insolvency or the filing of a bankruptcy petition was an Event of Default, giving CITBC or Two Trees the right to terminate the lease was unenforceable under section 365(e)(1) of the Bankruptcy Code. There is no evidence or even contention that the Debtor was otherwise in default in July 1998. The record does not show whether the lease was terminated prior to September 8, 1999, when Two Trees sold the Camden property. It could not have been terminated prior to the date it was deemed rejected, which did not occur until September 1998.

Thus, CITBC did not and could not "make demand for payment ... under the standby letter of credit" as a remedy for damages due to termination of the lease pursuant to section 15.2(c). CITBC unilaterally set in motion the events resulting in the payment on the letter of credit based on its own credit decisions and without knowledge of whether BTI would actually owe anything to Two Trees under the lease. In any event, section 15.2(c) is unenforceable as a liquidated damage provision because the amount of probable damage could not have been estimated by the parties at the time they entered into the lease. *See, Mosel v. Gosnell*, 334 S.C. 425, 431-432, 513 S.E.2d 123, 126-27 (1999) ("The test for determining whether a stipulation constitutes a penalty is whether 'the sum stipulated is so large that it is plainly disproportionate to any probable damage resulting from breach of the contract' *Tate [v Lemaster]*, 231 S.C. at 442, 99 S.E.2d at 46.") Further, the damages of the Lessor under the lease were readily ascertainable if a breach occurred, whether or not Two Trees elected to terminate the lease due to the breach, which negates the notion that this section was intended as a liquidated damage clause. *See Lipscomb v. Seegers*, 19 S.C. 425 (1883).

The lease agreement contains no provision governing the rights of the parties in the event that the amount of the obligations secured by the letter of credit was less than the amount drawn on the letter of credit. The obligation to return the excess is implied. "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Restatement (Second) of Contracts § 205 (1981). For Two Trees and CITBC to retain the proceeds of the letter of credit in excess of what Plaintiff owes under the lease would manifestly constitute a lack of

good faith and fair dealing, since the value that supported and paid for the funds received by CITBC and Two Trees ultimately came from property of the Debtor.

South Carolina law includes the doctrines of unjust enrichment and quasi-contract. A quasi-contract is "an obligation implied in law because of the conduct of the parties, or some special relationship between them, and because otherwise one of them would be unjustly enriched." Black's Law Dictionary, 7th Ed., p. 322. "[Q]uantum meruit, quasi-contract, and implied by law contract are equivalent terms for an equitable remedy" *Myrtle Beach Hosp., Inc. v. City of Myrtle Beach*, 341 S.C. 1, 532 S.E.2d 868 (2000).

> This Court has recognized quantum meruit as an equitable doctrine to allow recovery for unjust enrichment. *See Player v. Chandler*, 299 S.C. 101, 382 S.E.2d 891 (1989). Absent an express contract, recovery under quantum meruit is based on quasi-contract, the elements of which are: (1) a benefit conferred upon the defendant by the plaintiff; (2) realization of that benefit by the defendant; and (3) retention by the defendant of the benefit under conditions that make it unjust for him to retain it without paying its value. *Webb v. First Federal Savings and Loan Ass'n.*, 300 S.C. 507, 388 S.E.2d 823 (Ct.App.1989); *Ellis v. Smith Grading and Paving, Inc.*, 294 S.C. 470, 366 S.E.2d 12 (Ct.App.1988).

Columbia Wholesale Co., Inc. v. Scudder May N.V., 312 S.C. 259, 216, 440 S.E.2d 129, 130 (1994).

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The letter of credit permitted Two Trees to draw down the entire $1.6 million upon its early expiration but that possibility implies nothing with regard to what the letter of credit secured. The beneficiary had no control over CITBC and its ability to terminate the financing agreement with BTI and hence cancel its obligation to reimburse DK Bank. Either the beneficiary had to agree to no collateral if the letter of credit were terminated, or it had to have a mechanism to draw the amount of the letter of credit as a substitute for the letter of credit itself in the circumstance where the letter of credit was being withdrawn but unmatured obligations secured by the letter of credit remained open. A default by BTI under the lease agreement was not a precondition to the right to make such a draw. When this arrangement was made, no one could have predicted with certainty whether BTI would default and, if so, when. If following the termination of the letter of credit and draw of the proceeds by Two Trees, BTI had performed all of its obligations under the lease throughout the term of the lease, a legal opinion that Two Trees could have kept as a windfall the proceeds, which were ultimately supported by BTI's assets, would never be taken seriously. Similarly, CITBC's argument that this draw arrangement shows that the letter of credit secured the debt of Two Trees to CITBC is utterly preposterous.

Because the lease agreement does not speak directly to the issue of what becomes of excess security after the payment of Two Trees' claims under the lease, the Court may consider whether there is a quasi-contract to repay the overage or whether failure to repay the overage would result in unjust enrichment and order restitution if appropriate.

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Defendants would clearly be unjustly enriched if they were able to retain out of the $1.6 million, any amount exceeding the amount of the debt secured. BTI was not an eleemosynary institution. Defendants' contention that they should able to retain the entire $1.6 million without regard to what Two Trees is owed does not pass the laugh test.

Two Trees has applied duty to return the difference between the security for BTI's obligations under the lease and the amount of those obligations. It cannot escape liability for such a debt because of the conduct of its assignee. Moreover, the parties have stipulated that Two Trees received the benefit of the proceeds of the letter of credit; it was therefore unjustly enriched to the extent, if any, the security exceeded the debt. As general partners of Two Trees, the Walentases are liable for the debt, if any, of Two Trees to BTI. CITBC is also liable in the same amount because it occupied the position of Two Trees as its assignee. Although it was entitled to draw on the letter of credit, CITBC had no right under the lease agreement to dispense the proceeds for more than the amount that BTI owed Two Trees for breach of the lease. CITBC unjustly enriched itself to the extent of the overage, if any.

The amount of the debt owed by BTI to Two Trees and the amount of CITBC's claim against BTI were, with respect to the letter of credit, two ends of the same seesaw. If the claim of Two Trees is less than $1.6 million, CITBC overstated its claim against the estate. Count One is broad enough to include CITBC's obligation to repay the estate if it received more than what it was owed at the closing held on August 3, 1998. That is the import of the Court's July 10, 1998 Order.

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Defendants contend that the lease agreement was not a "true lease," but rather a disguised financing transaction. They make this argument to show that section 502(b)(6) of the Bankruptcy Code does not limit the damages that Two Trees can prove. Whether or not the Debtor owes rent for a period longer than one year, it is clear that the lease agreement is a true lease. BTI had no right to acquire the property at the end of the lease term and no obligation to renew the lease after the five-year term. The amount of the lease payments, if all of them had been paid, would have amortized less than 45% of the debt of Two Trees to CITBC and BTI had no obligation to renew the lease, which belies the contention that the lease was a financing arrangement to pay the debt of Two Trees to CITBC.

In support of its contention that the lease arrangement was a financing agreement, CITBC relies primarily on *In re PCH Associates*, 804 F.2d. 193 (2nd Cir. 1986). Deciding that the lease in that case was not a true lease, the Second Circuit noted various facts found by the bankruptcy court suggesting that the lease was not a true lease. Almost none of the facts there are similar to facts here. Most notably, the parties to the lease agreement in *PCH Associates* had the right to buy each other out under certain conditions, whereas here, BTI had no right to reacquire the Camden property. There the sole purpose of the transaction was tax avoidance. Here, Jerrold Brown of CITBC admitted that the purpose of the transaction was to increase liquidity. That liquidity included tax savings to be sure, but it also included what CITBC says was a handsome price for the property. The fact that under the lease the tenant paid all the operating expenses and taxes does not transform the lease into a financing vehicle.

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Westship, Inc. v. Trident Shipworks, Inc., 247 B.R. 856, 863 (M.D. Fla. 2000) ("While the Lease contains many indicia of ownership, this is common in triple net leases and does not necessarily indicate the absence of a lease.")

Next, CITBC contends that the termination agreement and the "voluntary payment doctrine" bar Plaintiff's claim. This waiver argument is also without merit. There is no language in the termination agreement or in the closing statement and agreement between BTI, Schneider and CITBC that purports to limit the rights of the Debtor against CITBC. The termination agreement does state that the second and fourth whereas clauses are subject to the rights of the Creditors' Committee and a Chapter 7 trustee, as set forth in paragraph O of the Cash Collateral Order. The second whereas clause states essentially that payment of CITBC's secured claim is secured by a first priority, perfected, non-avoidable security interest in the collateral described in the financing agreement. The Court reads that language as preserving a right to object to the perfection and priority of CITBC's security interests. Even that restriction is unenforceable because the Court's Order of July 10, 1998, not mentioned in the relevant portion of the agreement on which CITBC relies, reserved the right of the Debtor, the Creditors' Committee and any trustee to challenge perfection and priority, as well as amount, the amount, of CITBC's claim.

One purpose of the July 10, 1998 Order was to facilitate the closing with Schneider and thereby bestow significant and valuable benefits on the estate and creditors, including CITBC. A fight between the Debtor or the Creditors'

Committee and CITBC over its claim that delayed the closing and the release of CITBC's security interest in assets being acquired by Schneider could have allowed Schneider to back out of the deal. The means to accomplish this purpose was the reservation of any potential dispute relating to the amount of CITBC's claim or the priority or perfection of its interest in the Debtor's property securing that claim. Paragraph 10 of the Order authorized and directed the Debtor to pay whatever CITBC claimed it was owed, "without prejudice to any claim of the Debtor, any subsequently appointed Trustee and/or the Committee challenging the validity, priority, extent, perfection or amount of such claims asserted by CITBC and CITEF." The Debtor had no authority to waive or abandon claims of the estate against CITBC without notice to creditors and Court approval.

As to the "voluntary payment doctrine" under South Carolina state law, state law does not apply because the payment to CITBC was governed by this Court's Order reserving the right of the Debtor to challenge the amount of the claim. Finally on this issue, the cause of action involves more than the possible recalculation of CITBC's claim against the estate. It is a restitution claim, if not a fraud claim, as well as a claim under the July 10, 1998 Order. In making these frivolous arguments, CITBC acknowledges that the Debtor's claim in Count One and the right to challenge its claim under the financing agreement preserved by the July 10, 1998 are one and the same.

Plaintiff has met its burden of proving that it supplied the collateral in the amount of $1.6 million for its obligations under the lease agreement and has met its burden of going

forward to show that the lease claim of Two Trees and CITBC is less than the amount of the security (because it showed that it and Schneider paid postpetition rent and that the obligation to pay rent ended at the latest on September 8, 1999). The burden of proving the amount of debt owed by BTI to Two Trees is on Two Trees and CITBC, except as to disputes over the amounts of payments made by the Debtor or Schneider, as to which the burden of proof is on Plaintiff. While Plaintiff has asserted that Defendants have not shown that BTI owes Two Trees anything under the lease, Plaintiff has not shown that Defendants cannot prove such a debt. The assertion that Two Trees did not file a proof of claim is meaningless because secured creditors may look to their collateral without filing a claim. The Court notes that under the lease the landlord had the duty to mitigate, but there is no evidence to show when the lease was terminated, if it ever was before the property was sold, and what Two Trees did, if anything, to mitigate. Claiming that the non-moving party with the burden of proof has not or cannot meet it, without more, is not sufficient to show an absence of material fact on the issue on which the non-moving party has the burden of proof *United States v. Four Parcels of Real Property*, 941 F.2d 1428, 1437-1438 (11th Cir. 1991) (footnotes omitted). Therefore, the issue of damages must be tried.

The bankruptcy court in *In re Atlantic Container Corp.*, 133 B.R. 980 (Bankr. N.D. III. 1991) explained the property measure for computing a landlord's claim if section 502(b)(6) is applicable:

> [P]ost-petition rent payments are deducted from the landlord's total actual lease termination

> damages, before the § 502(b)(6) cap is applied.. [*In re Goldblatt Bros.*, 66 B.R. 337, 347-48 (Bankr. ND. Ill. 1986)]. The primary damage a landlord suffers upon termination of a lease is the loss of the future rental income the landlord expected to receive under the terminated lease. The landlord can mitigate these damages by reletting the property. Any rent the landlord receives from the property's new tenant reduces the landlord's total actual lease termination damages.

Id., at 989-90. See also, *In re First Alliance Corp.*, 140 B.R. 531 (9th Cir. BAP 1992); 4 Collier on Bankruptcy, ¶ 502.03[7][I], at 502-45(15th Edition).

In summary, as to Count One, the motions for summary judgment against Plaintiff filed by CITBC and by Two Trees and David and Jane Walentas are denied, and Plaintiff's motion for partial summary judgment is granted as to liability against all Defendants under section 542(b), denied as to liability under section 542(a) and denied as to damages.

CITBC moves for summary judgment against the other Defendants on its cross-claim if the Court enters judgment against it. Although factual issues remain that may or may not result in a judgment against CITBC, the Court is obliged to address the question whether it has subject matter jurisdiction to hear the dispute raised by the cross-claim, even though Two Trees and the Walentases did not raise this issue.

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Bankruptcy subject matter jurisdiction is governed by 28 U.S.C. § 1334. It includes jurisdiction of all cases under title 11 and extends to "civil proceedings arising under title 11, or arising in or related to cases under title 11," Cases "arising under title 11" are those proceedings which involve a cause of action created or determined by a statutory provision of title 11. *See Toledo v. Sanchez (In re Toledo)*, 170 F.3d 1340, 1345 (11th Cir.1999) citing, *Wood v. Wood (In re Wood)*, 825 F.2d 90, 97 (5th Cir. 1987); 1 Lawrence P. King, Collier on Bankruptcy ¶3.01[4][c][1] (15th ed. 1998). The cross-claim is not a case under title 11 and does not arise under title 11.

That leaves "related to" jurisdiction. The seminal case in the Eleventh Circuit for determining the scope of the bankruptcy court's "related to" jurisdiction over an adversary proceeding *is Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784 (11th Cir.1990). In *Lemco Gypsum*, the Court of Appeals adopted the test used in *Pacor, Inc. v. Higgins*, 743 F.2d 984 (3d Cir.1984) for determining jurisdiction over an adversary proceeding:

> "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy. The proceeding need not necessarily be against the debtor or the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any

way impacts upon the handling and administration of the bankrupt estate."

Lemco Gypsum, 910 F.2d at 788 (quoting *Pacor*, 743 F.2d at 994); *see also Celotex Corp.*, 514 U.S. at 308 n.6, 115 S.Ct. at 1499 n.6 (expressing approval of the *Pacor* test).

"The key word in the *Lemco Gypsum /Pacor* test is 'conceivable,' which makes the jurisdictional grant extremely broad." *In re Toledo*, 170 F.3d 1340, 1345 (11th Cir. 1999). The grant is very broad but not unlimited. CITBC's cross-claim is based on the loan it made in 1995 to Two Trees. If it were to prevail on its cross-claim, that result could not conceivably "alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively)" or have any other effect "upon the handling and administration of the bankrupt estate." Hence, the cross-claim is dismissed for lack of jurisdiction, and CITBC's motion for summary judgment against Two Trees and the Walentases is denied as moot.

Now the Court turns to CITBC's motion for summary judgment on Counts Two, Four and Five. There are a few further relevant factual issues raised that go beyond the central narrative of the relationships among these parties.

Plaintiff alleges that CITBC has breached its obligations under Section 3(d) of the termination agreement regarding money in the "Remaining L/C Cash Collateral Account," as defined in the termination agreement. BTI alleges, and CITBC admits, that at the time of the complaint all of the remaining letters of credit had been drawn, expired in

accordance with their terms, or surrendered to CITBC for cancellation. BTI alleges that CITBC has breached the termination agreement by refusing to disburse all of the amounts due for disbursement under Section 3(d) or to account to BTI for the use of funds that were in or should have been credited to the Remaining L/C Cash Collateral Account. This account was set up at the closing with Schneider and CITBC for the purpose of covering any subsequent draws on outstanding letters of credit.

The termination agreement also provided for a "Remaining Legal Contingency Cash Collateral Account," in addition to the Remaining L/C Cash Collateral Account. CITBC indicates that for administrative convenience it combined these two Accounts. The proper disposition of approximately $150,000.00 designated as the Remaining Legal Contingency Cash Collateral Account is the subject of Count Five.

BTI maintains that it is unable to determine whether CITBC performed its obligation properly as to the Remaining L/C Cash Collateral Account. According to CITBC, on or about July 12, 1999, it disbursed to BTI the remaining funds in the Remaining L/C Cash Collateral Account in the amount of $161,492.25, inclusive of all interest, by wire transfer and retained $150,000.00 that it says is part of the Legal Contingency Fund. Many of the factual issues raised by BTI in its complaint have been resolved through discovery. The only issue remaining for BTI is its claim for an account statement for the Remaining L/C Cash Collateral Account for the month of September 1998.

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CITBC argues that BTI had not raised issues about the Remaining L/C Cash Account prior to the filing of the complaint. It contends that it has satisfied its burden of showing that this Count is without merit or no longer at issue, except as to fees it charged for September 1998, which it believes could be resolved by submission of an additional affidavit providing an accounting of all fees and expenses charged to the L/C Account for that month. The problem with that suggestion is that it acknowledges the existence of a disputed material fact with regard to this account, and for that reason CITBC's motion for summary judgment on Count Two is denied. In managing the preparation of a pre-trial order, however, the Court will expect both sides to be prepared to discuss the accounting issues in great detail in an effort to articulate precisely what the parameters are of the remaining factual disputes.

In Count Four, BTI alleges that CITBC has failed to show why three specific payments made by CITBC and charged against BTI's line of credit account under the termination agreement were reasonable fees pursuant to or within the meaning of section 506(b) of the Bankruptcy Code.

BTI questions the following fees:

1. $144,737.13 paid to Phoenix Advisors for consulting services regarding the collection of accounts and developing a wind down plan for tractors and trailers.

2. $35,000 "paid or to be paid to Equipment Sales for asset location and marshaling services."

3. At least $27,353.47 "paid to RN Management, Inc., for consultant fees."

Under Count Four, BTI seeks judgment against CITBC for a total of $207,090.60.

As to the first disputed charge, CITBC admits that it charged and collected from BTI the amount of $144,737.13 for fees associated with Phoenix Advisors. CITBC denies the allegation that this fee was not reasonable and states that it has shown this fee was reasonable within the meaning of § 506(b).

As to the second disputed charge, CITBC admits that it charged and collected from BTI the amount of $35,000 for fees associated with Equipment Sales but denies the allegations that this fee was not reasonable. Martin Edens, the proprietor of Equipment Sales, swore in an affidavit that his company was not hired to perform any duties but was rather a prospective purchaser. Mr. Edens stated that Equipment Sales had an agreement with CITBC to purchase 1,334 of BTI's trailers, but that CITBC later refused to sell the trailers and paid Equipment Sales $35,000.00 as damages. BTI has presented affidavits that the work of locating and marshaling the trailers was performed by John Richard Morris and by BTI personnel. Material factual disputes remain as to this issue.

CITBC denies the allegations by BTI that fees of $27,353.47 associated with RN Management, Inc. were not reasonable. Exactly when BTI was charged and when this money was paid to RN Management is unclear and appears

to be in dispute. CITBC apparently retained Joseph Nemia from RN Management to audit BTI's budget and cash flow, determine the integrity and accuracy of the company's cash reporting and cash projection systems and reconcile CITBC's loan balance to the company's general ledger. Mr. Nemia charged CITBC a flat rate of $550 per day plus out-of-pocket expenses, a rate which BTI agrees was very reasonable. Mr. Guthrie asserts that, while the first several invoices are reasonable, Mr. Nemia was not doing very much work during the time period from July 6 through July 31, and yet his services were charged at a flat per diem rate.

CITBC takes the same position concerning these charges as it did with respect to Count One that any dispute concerning these charges are barred by the termination agreement The answer to this contention is also same. The right of the Debtor to challenge any portion of CITBC's claim was preserved by the July 10, 1998 Order.

Because the parties dispute the material facts underlying this claim, CITBC's motion for summary judgment as to Count Four is denied.

In Count Five, BTI asks the Court to compel CIT[illegible]o pay over the funds in the Remaining Legal Contingency Cash Collateral Account. According to the evidence presented by CITBC, the amount remaining in the Remaining Legal Contingency Cash Collateral Account, pursuant to the termination agreement, is approximately $150,000.00. According to Plaintiff, there may be some accrued interest as well. BTI framed Count Five as a demand for an accounting of all funds "that were or should have been

deposited or accrued in the legal contingency account; requiring CITBC to turn over to BTI, for deposit in the Seller's Sales Proceeds Sequestration Account, all amounts that are in, or should have been credited to, the Remaining Legal Contingency Cash Collateral Account, pursuant to § 542 or § 543, and as prescribed in Section 8(d) of the Termination Agreement" Specifically, BTI contends that section 8(c) or 8(d) of the termination agreement controls the application or disbursement of these funds.

Sections 8 (c) and 8 (d) of the termination agreement state in relevant part:

> (c) CITBC shall apply amounts in the Remaining Legal Contingency Cash Collateral Account to pay the amount of any Remaining Legal Contingency Indemnification Obligations incurred by it, provided that a court of competent jurisdiction hearing any claim or action brought against CITBC or the Lenders by the Seller or any of its affiliates or the Creditors Committee has determined that CITBC is entitled to payment of such amount pursuant to the CITBC Financing Agreement.
>
> (d) Upon either receipt by CITBC of a full and complete release from both the Seller and its affiliates and the Creditors' Committee or (ii) *determination by a court of competent jurisdiction hearing any claim or action brought against CITBC or the Lenders* by *the Seller or any of its affiliates or the Creditors' Committee that CITBC*

is not entitled to payment of all or any amount claimed by it as part of the Remaining Legal Contingency Indemnification Obligations pursuant to the CITBC Financing Agreement, the amount of the Remaining Legal Indemnification Cash Collateral (or such portion thereof to which such court has determined CITBC is not entitled), shall be disbursed by CITBC to the Seller's Sale Proceeds Sequestration Account. All disbursements to the Seller's Sale Proceeds Sequestration Account under this Section 8(d) shall be made by wire transfer to the address set forth in Section 2(f). [Emphasis added.]

. . .

The termination agreement defines the terms used in these sections as follows:

"Remaining Legal Contingency Cash Collateral": the cash collateral to be held by CITBC pursuant to Section 8 hereof as security for payment of the Remaining Legal Contingency Indemnification obligations, and applied and disbursed pursuant to such Section 8, in an amount equal to the sum at any time of: (I) the Initial Remaining Legal Contingency Cash Collateral Deposit; plus (ii) interest accrued pursuant to Section 8 (b) hereof; less (iii) amounts applied from time to time bv CITBC pursuant to Section 8 (c) hereof, and less (iv) amounts disbursed from time to time by CITBC pursuant to Section 8 (d) hereof.

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"Remaining Legal Contingency Cash Collateral Account": a separate account established and maintained by CITBC under its control and direction in which the Remaining Legal Contingency Cash Collateral shall be deposited and retained, in accordance with and subject to the provisions of Section 8 hereof.

"Remaining Legal Contingency Indemnification Obligations": the obligation of the Seller to reimburse CITBC's "Out-of-Pocket Expenses" (as defined in the CITBC Financing Agreement) incurred in the defense of any claim or action which may be brought against CITBC or the Lenders by the Seller or any of its affiliates or the Creditors' Committee in connection with the CITBC Financing Agreement, the loans and commitments thereunder and the transactions arising thereunder or in any other matters arising in connection therewith.

The CITBC Financing Agreement defines "Out-of-Pocket Expenses" as "all of [CITBC's] present and future expenses incurred relative to [the CITBC Financing Agreement], whether incurred heretofore or hereafter" and includes in the definition CITBC's counsel fees and local counsel fees.

BTI alleges, and CITBC admits, that CITBC has not obtained a decision of any court of competent jurisdiction that CITBC is entitled to any money in the account as provided in section 8(c) of the termination agreement. CITBC

takes the position that a triggering event under section 8(d)(I) has not occurred, and, therefore it is not obligated to return the money at this time. That event is that CITBC has not received a complete release from both Schneider and the Creditor's Committee. Indeed, according to CITBC, it is allowed under that section to retain the money in the account indefinitely in the event a lawsuit is brought by either the Creditors' Committee or Schneider in the future challenging the validity, priority, or perfection of CITBC's liens. CITBC states that it is entitled to recover the money in the account for the costs and expenses of defending this adversary proceeding and has suggested the Court address in the same or in a separate order CITBC's request for permission to deduct from the legal contingency account its fees and expenses incurred in defending this adversary proceeding. BTI asserts that CITBC simply has not shown as a matter of law that it is entitled to draw from the account for defending this adversary proceeding. Here again, there are material facts in dispute. To the extent that Schneider and the Creditors' Committee are refusing to deliver releases, it may be necessary for Plaintiff to bring an adversary proceeding against Schneider and the Creditors' Committee for a declaratory judgment or injunctive relief. Or it can abandon Count Five.

Based on this analysis, it is

ORDERED that Plaintiff's motion for summary judgment on Count One of the complaint is GRANTED against all Defendants as to liability under 11 U.S.C. § 542(b) and DENIED against all Defendants as to liability under 11 U.S.C. § 542(a) and as to damages; that Defendant

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CITBC's motion for summary judgment against Plaintiff on Counts One, Two, Four and Five is DENIED, that the cross-claim of CITBC against Defendants Two Trees, David C. Walentas and Jane Walentas is DISMISSED for lack of subject matter jurisdiction and that CITBC's motion for summary judgment on its cross-claim is DENIED as moot; and that the motion of Defendants Two Trees, David C. Walentas and Jane Walentas against Plaintiff is DENIED.

This 30th day of September, 2002.

s/ James E. Massey
JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE